exposure draft

ACCOUNTING STANDARDS BOARD
PROPOSED INTERNATIONAL FINANCIAL REPORTING STANDARDS

Financial Instruments: Classification and Measurement

August 2009

COMMENTS TO THE IASB MUST BE RECEIVED BY SEPTEMBER 14, 2009

COMMENTS TO THE AcSB MUST BE RECEIVED BY SEPTEMBER 30, 2009

This Exposure Draft of proposed International Financial Reporting Standards reflects proposals made by the IASB that the AcSB intends to adopt as Canadian generally accepted accounting principles.

Individuals and organizations are invited to send written comments on the Exposure Draft proposals. Comments are requested from those who agree with the Exposure Draft as well as from those who do not.

Comments are most helpful if they are related to a specific paragraph or group of paragraphs, and, when expressing disagreement with the Exposure Draft, they clearly explain the problem, and include a suggested alternative supported by specific reasoning. All comments received by the AcSB will be available on its website at www.acsbcanada.org 10 days after the comment deadline, unless confidentiality is requested.

To be considered, comments to the AcSB must be received by September 30, 2009, addressed to:

Peter Martin, CA
Director, Accounting Standards
Accounting Standards Board
277 Wellington Street West
Toronto, Ontario M5V 3H2

For ease of handling, we prefer comments to be sent by e-mail (in Word format) to:
ed.accounting@cica.ca

Highlights

The Accounting Standards Board (AcSB) proposes, subject to comments received following exposure, to incorporate into Canadian GAAP the new standard on classification and measurement of financial instruments resulting from the Exposure Draft recently issued by the International Accounting Standards Board (IASB). The proposed new standard would replace corresponding requirements in International Financial Reporting Standard (IFRS) IAS 39 *Financial Instruments: Recognition and Measurement*.

Background

The AcSB's strategy for publicly accountable enterprises, other than pension plans, is to adopt IFRSs as Canadian GAAP for interim and annual financial statements related to fiscal years beginning on or after January 1, 2011. Other entities may choose to adopt IFRSs. The IASB has recently issued for comment its Exposure Draft, "Financial Instruments: Classification and Measurement" (the ED). Consistent with its strategy, the AcSB intends to adopt the classification and measurement requirements proposed in the ED in place of the corresponding requirements in IAS 39. The IAS 39 requirements were previously exposed as part of the AcSB's April 2008 Exposure Draft, "Adopting IFRS in Canada."

IASB Exposure Draft

The IASB's ED, "Financial Instruments: Classification and Measurement," is available on the IASB website at www.iasb.org.

Main features

The ED proposes that all financial instruments would be classified into one of two basic categories:
- measured at amortized cost; or
- measured at fair value.

Classification would be made on the basis of both the characteristics of the instrument and the business model under which it is managed. The ED proposes a fair value option that would permit an entity to measure at fair value a financial instrument that would otherwise be measured at amortized cost when doing so would prevent an accounting mismatch.

Classifications would be made on initial recognition and irrevocable.

Amortized cost
Except when the fair value option is applied, amortized cost measurement, calculated using the effective interest method as currently specified in IAS 39, would be required for financial instruments that:
- have basic loan features; and
- are managed on a contractual yield basis.

Management on a contractual yield basis would be determined at the business unit level. A financial instrument has basic loan features when it requires repayment of both a principal amount and an interest amount. Interest must be calculated as compensation for the time value of money and credit risk. Features such as prepayment options and interest rate caps, collars and floors would not prevent a financial instrument from being classified as having basic loan features. However, a financial instrument that contains other types of embedded derivatives, for example, is indexed to commodity prices, or incorporates leverage, does not have basic loan features and would be measured at fair value. A financial instrument that is designed to absorb credit losses would also not be eligible for amortized cost measurement.

Fair value
All financial instruments that are not measured at amortized cost would be measured at fair value. This would be a change in practice for unquoted equity investments and derivatives that are based on and require settlement by delivery of such equity instruments. Currently, these financial instruments may be measured at cost.

On initial recognition, an entity would be able to elect irrevocably to present changes in fair value, together with dividends earned, in other comprehensive income for any investment in an equity instrument that is not held for trading. These amounts would not be subsequently transferred to net income.

Changes in fair value for all other financial instruments measured at fair value would be recognized in net income.

Simplifications from existing standard
The proposed model would simplify many aspects of financial instrument accounting, including the following:
- The tainting rules for held-to-maturity investments would be avoided because classification is not predicated on intention or ability to hold a specific financial instrument for any period of time.
- Financial instruments with embedded derivatives would not be separated into a fair value component and a cost or amortized cost component.
- Income currently reported in other comprehensive income and subsequently recycled to net income would be reported in a single location.

Related projects

The IASB plans to replace IAS 39. It has decided to expose specific issues separately.

This ED is the second of four exposure drafts the IASB plans to issue in 2009. Proposed revisions to the derecognition provisions of IAS 39 were exposed in May for comment by July 31. Revisions to the impairment requirements are expected to be exposed in October and revised hedge accounting provisions are expected to be exposed in December. The IASB has also issued two other documents for comment associated with the replacement of IAS 39 — the Discussion Paper, "Credit Risk in Liability Measurement" and the Request for Information on an expected loss model for impairment of financial assets. Other issues will be addressed, as necessary, in 2010.

Convergence with US GAAP

As part of the February 2006 Memorandum of Understanding between the IASB and the Financial Accounting Standards Board (FASB), the Boards committed to developing a common, simplified standard for financial instruments. The Boards jointly issued a Discussion Paper, "Reducing Complexity in Reporting Financial Instruments," in March 2008. The Boards decided to deliberate individual issues separately but continue to discuss how input from their separate projects can be combined to achieve a converged standard. The status of FASB's deliberations can be viewed at www.fasb.org.

Timing of adoption in Canada and transitional provisions

The IASB has not yet determined the effective date of the proposed new IFRS, but currently expects to issue it before the end of 2009. Assuming this timetable is met, the AcSB intends to incorporate the new standard into Canadian GAAP at that time as part of the IFRSs to be adopted by publicly accountable enterprises, other than pension plans, in 2011. The new standard would not be available as part of existing Canadian GAAP but would be available through early adoption of IFRSs.

The proposed new standard would apply prospectively as of the beginning of the first annual period after the mandatory effective date (expected to be the beginning of 2012).

Publicly accountable enterprises and other entities choosing to adopt IFRSs are encouraged to review and consider the implications of the proposed transitional provisions in planning their initial adoption of IFRSs and in commenting on the proposals. Entities should pay particular attention to the proposed amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* relative to the transitional provisions in the proposed standard and their plans for the changeover to IFRSs.

Comments requested

The AcSB encourages Canadian stakeholders to respond to the IASB on its ED since the proposed new IFRS will become part of Canadian GAAP when finalized. Specific questions on which the IASB would like input are provided in the Invitation to Comment in its ED. The AcSB requests that comment letters be sent directly to the IASB with a copy to the AcSB.

The AcSB has identified additional questions regarding the proposed new standard on which it would like input from Canadian respondents.

1. The proposed new standard has been developed by the IASB for application by entities around the world. Assuming the ED proposals are approved by the IASB, do you believe that there are aspects of the proposed new standard that make some or all of it inappropriate for Canadian entities, even though it is appropriate for entities in the rest of the world? If so, please specify which aspects and what circumstances make the accounting requirements proposed in the ED inappropriate for Canadian entities.

2. The AcSB has determined that it will generally not issue application or interpretative guidance on IASB standards. An exception might be when an aspect of a standard needs interpreting in light of specific Canadian legal, tax, regulatory or other circumstances that do not apply in other countries and, therefore, will not be addressed by the IASB. Do the proposals in the ED require such application or interpretative guidance? If so, please specify the issue giving rise to the need for additional material, the reasons additional guidance is required and the nature of that guidance.

3. The AcSB has decided against incorporating the proposals in the ED into existing Canadian GAAP because it would be very difficult for an entity to

assess whether the proposals should be implemented without analyzing revisions to the impairment and hedge accounting provisions. Do you agree that the classification and measurement revisions should be available only on adoption of IFRSs? If not, please provide in detail reasons for amending Canadian GAAP.

Responses to these additional questions should be sent directly to the AcSB.

The deadline for commenting to the IASB on its ED is September 14, 2009. The deadline for responding to the AcSB on the additional questions set out above is September 30, 2009.