

How the IASB has responded to European concerns

Concern raised with the IASB	IASB response
<p>ECOFIN asked the IASB to resolve the issue of impairment of available-for-sale (AFS) debt instruments that are measured at fair value by the end of 2009.</p>	<p>IFRS 9 <i>Financial Instruments</i> addresses this issue by requiring impairment only for debt instruments measured at amortised cost. For such instruments impairment is determined using a cash flow (rather than fair value-based) impairment model.</p> <p>IFRS 9 is available for application in 2009 year-end financial statements, subject to endorsement by the EU.</p>
<p>The European Commission expressed concerns that the proposals in the exposure draft would have resulted in expanded application of fair value accounting, in particular when it is not the most decision-useful measurement basis. It was both the G20's and ECOFIN Council's objective to ensure that accounting standards do not undermine financial stability while improving decision-usefulness and relevance – rather than simplification per se.</p>	<p>The overall objective of the IASB's project is to improve the ability of investors and other users of financial statements to understand the accounting for financial instruments. Simplification is a by-product of that objective. The Board believes that achieving this overall objective will improve investor confidence in the markets and enhance financial stability.</p> <p>The Board's objective is not to increase or decrease the application of fair value measurement, but rather ensure that financial assets are measured in a way that provides useful information to investors to help predict likely actual cash flows.</p> <p>During its redeliberations the Board changed its proposals for structured credit-linked investments and purchases of debt investments ('distressed' debt) in response to respondents' comments that amortised cost could provide useful information. It is also important to note that the scope of the fair value option has not been broadened.</p>
<p>The European Commission expressed concerns that the amortised cost qualification criteria are too narrow. In particular the business model should be given more prominence and the accounting for credit-linked instruments and distressed debt was seen as not appropriate. This is consistent with the views expressed by the Basel Committee and the FSB.</p>	<p>In response to suggestions from many respondents the business model is now assessed first. Only if financial assets are within a 'contractual cash flow collection' business model are the contractual cash flow characteristics of the individual instruments assessed to ensure that amortised cost can provide useful information.</p> <p>As noted above, the Board changed the treatment of credit-linked instruments and distressed debt.</p> <p>The business model has also been given greater prominence through the decision on reclassification (see below).</p>
<p>The European Commission noted that the proposals could lead to a reversal of reclassifications implemented in October 2008 which would be an unwanted policy reversal of the reclassification implemented last year, would be unwarranted from an economic point of view and would be politically contentious. In addition, the EC noted that the final guidance should permit reclassification in case the business model changes.</p>	<p>However, the Board's redeliberations on structured credit-linked investments may be relevant to many reclassified assets. As a result of the Board's change in the treatment of structured credit-linked investments more reclassified assets should be eligible for amortised cost measurement than under the proposals in the ED.</p>
<p>The European Commission requested that recycling of gains/losses on realisation and recognition of dividends in income be allowed for equity investments whose fair value changes are presented in other comprehensive income (OCI).</p>	<p>The ED proposed prohibiting the recognition of any gain/losses on equity investments whose fair value changes are presented in OCI.</p> <p>In response to the suggestions made, IFRS 9 requires the recognition of dividend income in profit or loss for such equity instruments. This approach avoids the need for complex and problematic impairment tests for such investments.</p>
<p>The effect on insurance companies was also identified as an area of concern by the European Commission.</p>	<p>The Board moved the mandatory effective date of IFRS 9 to 1 January 2013 to align the effective date with phase 2 of the project on accounting for insurance contracts. The Board noted that if that phase is delayed (and/or other phases of the replacement of IAS 39 such as impairment mean a later date is needed) the effective date of IFRS 9 would be revised.</p>
<p>The European Commission questioned the proposal to remove bifurcation of embedded derivatives, especially in the context of financial liabilities.</p>	<p>IFRS 9 eliminates bifurcation accounting for financial assets, which has been problematic in practice, is complex and would represent a different classification approach for hybrid contracts than for all other contracts.</p> <p>However, the guidance for financial liabilities on separating embedded derivatives will remain in place (see below).</p>
<p>The European Commission was concerned about financial liabilities being within the scope of this phase.</p>	<p>During its redeliberations the Board decided to exclude financial liabilities from this phase of the project and to address the issue shortly after IFRS 9 has been issued.</p>

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IASB response

The EC asked the Board to avoid overly burdensome transition requirements for early adopters.

IFRS 9 provides greater relief on transition than was proposed in the ED. In particular (and in response to the suggestions made by many respondents) IFRS 9 does not require the restatement of comparative information for entities adopting IFRS 9 early before 2012.

The EC asked the Board to achieve convergence with the FASB.

The project is a joint project and both boards are aiming to achieve a common solution. The boards held joint round tables in September and the FASB is participating in our redeliberations.

The boards have agreed to meet jointly on a monthly basis with the objective of meeting the timetable set out in the Memorandum of Understanding.