IASB addresses ‘counter-intuitive’ effects of fair value measurement of financial liabilities

The International Accounting Standards Board (IASB) today published for public comment its proposed changes to the accounting for financial liabilities. This proposal follows work already completed on the classification and measurement of financial assets (IFRS 9 Financial Instruments).

The IASB is proposing limited changes to the accounting for liabilities, with changes to the fair value option. The proposals respond to the view expressed by many investors and others in the extensive consultations that the IASB has undertaken—that volatility in profit or loss resulting from changes in the credit risk of liabilities that an entity chooses to measure at fair value is counter-intuitive and does not provide useful information to investors.

When the IASB introduced IFRS 9 many stakeholders around the world advised the IASB that the existing requirements for financial liabilities work well, except for the effects of changes in the credit risk of a financial liability (‘own credit’) that an entity chooses to measure at fair value.

Building on that global consultation on IFRS 9, the IASB sought the views of investors, preparers, audit firms, regulators and others on the ‘own credit’ issue. The views received were consistent with the earlier consultations—that volatility in profit or loss resulting from changes in ‘own credit’ does not provide useful information except for derivatives and liabilities that are held for trading.

The IASB is therefore proposing that all gains and losses resulting from changes in ‘own credit’ for financial liabilities that an entity chooses to measure at fair value should be transferred to ‘other comprehensive income’. Changes in ‘own credit’ will therefore not affect reported profit or loss.

No other changes are proposed for financial liabilities. Therefore, the proposals will affect only those entities that choose to apply the fair value option to their financial liabilities.
Importantly, those who prefer to bifurcate financial liabilities when relevant may continue to do so. That is consistent with the widespread view that the existing requirements for financial liabilities work well, other than the ‘own credit’ issue that these proposals cover.

Commenting on the proposals, Sir David Tweedie, Chairman of the IASB, said:

Whilst there are theoretical arguments for treating financial assets and liabilities in the same way it is hard to defend the accounting as providing useful information when a company suffering deterioration in credit quality is able to book a corresponding large profit, especially when investors tell us that such information is often excluded from their financial models.

An IASB ‘Snapshot’, a high level summary of the proposals, is available to download free of charge from the IASB website at http://go.iasb.org/financial+liabilities

The exposure draft Fair Value Option for Financial Liabilities is open for comment until 16 July 2010. It can be accessed via the ‘Comment on a proposal’ section on www.iasb.org from today.

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Press enquiries:
Mark Byatt, Director of Corporate Communications, IASB,
telephone: +44 (0)20 7246 6472, email: mbyatt@iasb.org
Sonja Horn, Communications Manager, IASB,
telephone: +44 (0)20 7246 6463, email: shorn@iasb.org

Technical enquiries:
Liz Figgie, Technical Principal, IASB
telephone: +44 (0)20 7246 6425, email: efiggie@iasb.org
Sue Lloyd, Associate Director, IASB
telephone: +44 (0)20 7246 6454, email: slloyd@iasb.org
Gavin Francis, Director of Capital Markets, IASB
telephone: +44 (0)20 7246 6901, email: gfrancis@iasb.org

Notes for editors

About the IASB

The IASB was established in 2001 and is the standard-setting body of the International Accounting Standards Committee (IASC) Foundation, an independent private sector, not-for-profit organisation. The IASB is committed to developing, in the public interest, a single set
of high quality, global accounting standards that provide high quality transparent and comparable information in general purpose financial statements. In pursuit of this objective the IASB conducts extensive public consultations and seeks the co-operation of international and national bodies around the world. The IASB currently has 15 full-time members drawn from ten countries and with a variety of professional backgrounds. By 2012 the IASB will be expanded to 16 members. Board members are appointed by and accountable to the Trustees of the IASC Foundation, who are required to select the best available combination of technical expertise and diversity of international business and market experience. In their work the Trustees are accountable to a Monitoring Board of public authorities.