

International Accounting Standards Board

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## Request for views

on

- Proposed FASB Amendments on Fair Value Measurement
- Proposed FASB Amendments to Impairment Requirements for Certain Investments in Debt and Equity Securities

March 2009

## IASB REQUEST FOR VIEWS

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### **Links to FASB documents:**

FASB proposed FSP No. FAS 157-e *Determining Whether a Market is Not Active and a Transaction is Not Distressed* [\[follow this link\]](#)

FASB proposed FSP No. FAS 115-a, FAS 124-a, and EITF 99-20-b *Recognition and Presentation of Other-Than-Temporary Impairments* [\[follow this link\]](#)

## **Introduction**

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1. In October 2008 the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) announced their joint approach to dealing with reporting issues arising from the global financial crisis. The boards reiterated the importance of working co-operatively and in an internationally co-ordinated manner to consider accounting issues emerging from the global financial crisis.
2. The boards agreed on the following measures:
  - (a) to hold public round tables in Asia, Europe and North America to identify any urgent accounting issues that needed to be addressed;
  - (b) to establish and receive input from a high level advisory group; and
  - (c) to develop comprehensive joint solutions to the reporting for financial instruments.
3. The boards set up the Financial Crisis Advisory Group (FCAG) in December 2008. The FCAG met in London on 20 January 2009 and in New York on 13 February and 5 March. Further meetings are scheduled for April and May 2009.
4. The boards held public round tables in November and December 2008 in London, Norwalk and Tokyo.
5. In summary, the overall themes that emerged from those public round tables were:
  - (a) the importance of broad convergence between International Financial Reporting Standards (IFRSs) and US generally accepted accounting principles (GAAP);
  - (b) that while no issues were identified that required urgent and immediate attention as a result of the global financial crisis, a comprehensive approach to improving the reporting for financial instruments should be developed by the boards as a matter of urgency; and

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- (c) the importance of ensuring sufficient due process before any changes are made by the IASB or the FASB. Participants noted that accelerated efforts in complex areas could result in unhelpful reporting and unintended consequences.
  
- 6. Some stakeholders have emphasised the priority of eliminating the differences between IFRS and US GAAP requirements for financial instruments to avoid opportunities for regulatory arbitrage, but this view is not shared among all interested parties. Many round-table participants (especially users of financial statements) noted that IFRS and US GAAP requirements for financial instruments are different in many areas today, and that any attempt to achieve convergence of requirements in the very short term will be difficult, arguably even impossible. Those participants emphasised that short-term changes attempting to create a ‘level playing field’ could undermine the quality of financial reporting and undermine investor confidence in financial markets, because of the temptation to ‘cherry-pick’ particular requirements that provided a desired accounting answer while ignoring other related requirements that are not as attractive.
  
- 7. Many respondents to recent IASB exposure drafts (for example *Investments in Debt Instruments* and *Embedded Derivatives*, published in December 2008) also emphasised:
  - (a) the importance of a sufficient due process—especially having a sufficient comment period to respond to any proposals;
  - (b) that short-term, piecemeal changes are often not adequately developed and are disruptive and that the IASB should focus on its major projects, which allows complex interrelated issues to be addressed more comprehensively; and
  - (c) that effective dates for any final amendments should always be set far enough in the future to permit any national or other required endorsement process to be completed as well as provide sufficient lead time for implementation.

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8. Each board has added a project on the recognition and measurement of financial instruments to its active agenda. The IASB expects this project to result in the replacement of IAS 39 *Financial Instruments: Recognition and Measurement*. The first joint meeting of the boards at which this project will be discussed will be in March 2009.
  9. In response to a study by the US Securities and Exchange Commission (SEC) in which the SEC recommended that the FASB evaluate the need (a) to improve the application and practice related to existing fair value measurements, and (b) for modifications to current other-than-temporary impairment guidance, the FASB undertook projects in those areas. On 17 March 2009 the FASB published two proposed FASB Staff Positions (FSPs):
    - (a) proposed FSP No. FAS 157-e *Determining Whether a Market is Not Active and a Transaction is Not Distressed*. That document proposes additional guidance on determining whether a market for a financial asset is not active and a transaction is not distressed for fair value measurements under FASB Statement No. 157 *Fair Value Measurements*.
    - (b) proposed FSP No. FAS 115-a, FAS 124-a, and EITF 99-20-b *Recognition and Presentation of Other-Than-Temporary Impairments*. That document proposes amendments to the impairment approach for financial assets in the form of securities. The amendments are intended to address long-standing application issues identified in US GAAP.
- The FASB has a 15-day comment period for these proposals ending on 1 April.
10. The IASB did not participate in the development of the FASB's proposed FSPs and has not deliberated any of the FASB's conclusions. The proposed FSPs represent the views of the FASB only.

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11. Though the proposed FSPs are a direct response to US-specific requests, the IASB believes that (in the light of its commitment to work jointly with the FASB to address issues arising from the financial crisis) it would be useful to seek the views of interested parties on the FASB's proposed FSPs.
12. This request for views is not an IASB due process document. Any action taken by the IASB will be subject to the IASB's due process.
13. The IASB would like to receive any views by **20 April 2009**. Respondents should communicate their views by email to: [iasb@iasb.org](mailto:iasb@iasb.org).

### **Fair value measurement**

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14. The FASB has proposed additional guidance on determining whether a market for a financial asset is not active and a transaction is not distressed for fair value measurements under SFAS 157.
15. IFRS fair value measurement requirements for financial instruments are set out in IAS 39 *Financial Instruments: Recognition and Measurement*. The IASB also expects to publish an exposure draft on fair value measurement in April 2009.
16. Additional educational material is set out in the report of the IASB Expert Advisory Panel *Measuring and disclosing the fair value of financial instruments in markets that are no longer active* [\[follow this link\]](#) that was published in October 2008. (The Panel comprised measurement experts from preparers and auditors of financial statements, users of financial statements, regulators and others – more detail about the Panel is available on the IASB website).
17. The Panel's report describes the objective of a fair value measurement: 'to arrive at the price at which an orderly transaction would take place between market participants at the measurement date'.

18. Paragraphs 21 – 25 of the Panel’s report discussed how to meet this objective in the context of determining whether a forced transaction exists. Those paragraphs emphasised that, in determining whether or not a forced transaction exists, (i) all relevant factors should be considered, and (ii) judgement is important.
19. The IASB would be interested in your views on whether you think the proposed FASB guidance is compatible with the objective of a fair value measurement as described in the Panel report and why or why not.

### **Impairment**

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20. To help inform those who wish to express their views to the IASB, this section contains:
- (a) a summary of relevant US GAAP and the proposed changes;
  - (b) a summary of relevant IFRS requirements;
  - (c) a summary of major differences between IFRSs and US GAAP (if amended as proposed); and
  - (d) concluding comments.

### **Summary of US GAAP and proposed changes**

21. For US GAAP the approach for securities within the scope of SFAS No. 115 *Accounting for Certain Investments in Debt and Equity Securities* requires the entire fair value change to be recognised in profit or loss once a fair value decrease is determined to represent ‘other-than-temporary impairment’ (commonly referred to as ‘OTTI’). The notion of ‘other than temporary’ is different from ‘permanent’. There is extensive FASB, SEC and other US accounting literature about the meaning of ‘other than temporary’. For example, factors considered under US GAAP include:
- (a) the length of time and extent that the market value is below cost;
  - (b) the financial condition and near-term prospects of the issuer; and

- (c) the intent and ability of the holder to retain the investment in the security to allow for any anticipated recovery in fair value.
22. These requirements apply to securities included in the held-to-maturity (HTM) category and the available-for-sale (AFS) category under US GAAP. Reversals of impairment losses through profit or loss are prohibited for both debt and equity securities.
23. The proposed FSP would change the impairment recognition and measurement requirements for securities classified as HTM and AFS under US GAAP.
24. The current indicator refers to management's intent and ability to hold an impaired security for a period of time sufficient to allow for any anticipated recovery in fair value. This would be replaced by a requirement to assert that:
- (a) management does not intend to sell the security; and
  - (b) it is more likely than not that management will not have to sell the security before recovery of its cost basis.
25. The total amount of an impairment loss recognised in profit or loss would change for debt securities in a scenario when there is a *credit loss* but management asserts that it does not intend to sell the security and it is more likely than not that it will not have to sell the security before recovery of its cost basis. In that scenario the fair value decrease would be disaggregated into:
- (a) the portion of the fair value decrease related to credit losses, which would be recognised in profit or loss; and
  - (b) the remainder of the fair value decrease (that relates to all other factors), which would be recognised in other comprehensive income (OCI).
26. An entity would have to change the presentation on the face of the income statement by first showing the total amount of the fair value decrease (impairment) and then presenting the amount recognised in OCI as a deduction from the total impairment.

### Summary of IFRS requirements

27. IAS 39 does not differentiate between financial assets on the basis of whether or not the asset is in security form; the IASB's constituency comprises many different legal jurisdictions, which makes the use of the term 'securities' problematic. Hence, a financial asset in security form could be classified in the AFS, HTM or loans and receivables (LAR) category in accordance with IFRSs if the relevant criteria are met.
28. The impairment approach for financial assets in the HTM and LAR categories of IAS 39 is based on an incurred loss model under which revised estimates of cash flows are discounted by the original effective interest rate of the instrument (or the current effective interest rate for variable interest rate instruments). In contrast, the AFS category of IAS 39 uses a fair value based measurement of impairment.
29. However, IAS 39 uses the same prerequisite of 'objective evidence of impairment' for an impairment loss to be recognised for all these three categories (AFS, HTM and LAR). Therefore, every impairment loss recognised in accordance with IAS 39 depends on the occurrence of a *loss event*. In contrast, the OTTI assessment under US GAAP also involves management intent (in addition to loss event type criteria—see paragraph 24 above).
30. Reversals of impairment losses in accordance with IAS 39 are accounted for as follows:
  - (a) for debt instruments, if the reversal of an impairment loss can be objectively related to an event after the impairment was recognised, the reversal is recognised in profit or loss; and
  - (b) for equity instruments, reversal of an impairment loss through profit or loss is prohibited. Under IFRSs prediction of any possible future recovery of an investment in an equity investment does not affect the accounting.

**Major differences between IFRSs and US GAAP (if amended as set out in proposed FSP No. FAS 115-a, FAS 124-a, and EITF 99-20-b)**

31. The following section sets out some of the major differences between IFRSs and US GAAP (if amended as proposed). There may be other differences as well.

*Scope differences*

32. The scope of the OTTI impairment test under US GAAP is different from the scope for the impairment tests of IAS 39:
- (a) US GAAP refers to ‘securities’ in setting the scope for the OTTI impairment test whereas the definitions of the categories of IAS 39 (which determine the applicable impairment test) do not involve the notion of ‘securities’.
  - (b) US GAAP uses the OTTI impairment test for securities classified as AFS or HTM whereas IAS 39 uses two different impairment tests: (i) the incurred loss approach for financial assets classified as LAR or HTM and (ii) the fair value based impairment test for financial assets classified as AFS. Thus, the HTM category is subject to entirely different impairment tests in accordance with US GAAP and IFRSs.

*Impairment triggers*

33. US GAAP and IAS 39 use impairment triggers that differ regarding the fundamental aspect of the effect of management intent and ability:
- (a) IAS 39 uses a *loss event* based trigger that (i) for debt instruments is credit risk related and (ii) for equity instruments considers in addition a ‘significant or prolonged’ decline in fair value and adverse changes in the technological, market, economic or legal environment. Thus, management intent and ability to continue holding an instrument are not factors in this assessment.

- (b) The OTTI approach in accordance with US GAAP also includes the intent and ability of management to retain the investment in the security to allow for any anticipated recovery in fair value.

*Measurement of impairment losses*

- 34. The measurement of the impairment loss in accordance with US GAAP and IAS 39 could be different:
  - (a) Once the impairment trigger is met, IAS 39 measures the impairment loss for AFS assets always as the entire fair value decline; for LAR and HTM assets the measurement is determined using the incurred loss model.
  - (b) The proposed changes to US GAAP could result in a scenario in which, if the impairment trigger related to management intent and ability is not met, the loss on a debt security would be disaggregated into (i) a credit related portion that is recognised in profit or loss (credit loss) and (ii) the remainder of the fair value change that is recognised in OCI.
- 35. Another difference in the measurement of the impairment loss could arise in relation to the measurement of what the proposed changes refer to as the *credit loss* (refer to paragraph 34(b) above):
  - (a) IAS 39 includes guidance on how to calculate the impairment loss under the incurred loss model for LAR and HTM assets, for example the applicable discount rate.
  - (b) The proposed changes to US GAAP do not include similar guidance but would provide more flexibility for entities in choosing an approach to measure the credit loss. Thus, although conceptually the losses determined as an incurred loss in accordance with IAS 39 and as a credit loss under the proposed changes to US GAAP are related to the same economic phenomenon, the approaches might not be comparable.

*Reversals of impairment losses*

36. US GAAP and IAS 39 have different requirements for reversals of impairment losses:
- (a) IAS 39 differentiates between (i) debt instruments, for which reversals are recognised in profit or loss (if conditions are met); and (ii) equity instruments, for which reversals of an impairment loss through profit or loss are prohibited.
  - (b) US GAAP does not allow any reversals of impairment losses. Instead, if impairment losses were recognised in profit or loss, the resulting carrying amount becomes the new cost basis of the impaired financial asset.
37. The new cost basis resulting from impairment losses recognised in profit or loss in accordance with US GAAP also creates a difference from IAS 39, which does not reset the cost basis of a financial asset as a result of an impairment loss. The difference in cost bases may have a knock-on effect on calculating interest revenue (using the effective interest method) after impairment recognition in accordance with US GAAP compared with IFRSs.

*Other aspects*

38. US GAAP also differs from IFRSs in the following aspects:
- (a) Guidance on the interpretation of OTTI is not confined to a specific FASB standard but is scattered across different pieces of literature, including SEC pronouncements. The interpretation of OTTI is also influenced by US practice that has evolved over the years. The relevant requirements for IFRSs are included in IAS 39 (and regarding specific aspects of interim reporting in IFRIC 10 *Interim Financial Reporting and Impairment*). Similarly, practice has evolved regarding the IFRS impairment tests over the years.

- (b) For HTM assets the proposed changes could result in a scenario in which the portion of a fair value decrease for an HTM security that is considered an OTTI but not a credit loss would be recognised in OCI. This would require a new category within OCI. That amount recognised in OCI would subsequently be amortised over the remaining life of the HTM security through OCI. In contrast, *amortisation* of amounts within OCI is an entirely new concept that IAS 39 currently does not envisage. Moreover, IAS 39 does not involve any recognition of amounts in OCI in relation to HTM assets.
- (c) The proposed way of disaggregating in some scenarios the entire fair value change for debt securities into the credit loss (recognised in profit or loss) and the remainder of the fair value change (recognised in OCI – refer to paragraph 34(b) above) may have unanticipated consequences for particular AFS assets. For example, there is uncertainty regarding the accounting for interest-only strips. If the prepayment risk increases in relation to an investment in an interest-only strip the fair value decrease would not be characterised as a credit loss. Thus, it appears that it could result in recognising the fair value decrease in OCI even though it is commonly considered an impairment loss because the recoverability of the fair value change is highly speculative.

### **Concluding comments**

39. Given the significant differences that exist between IFRS and US GAAP impairment requirements, any consideration by the IASB of the FASB proposals would entail substantial changes to IFRSs, and would also significantly delay the comprehensive joint IASB/FASB project to improve the reporting for financial instruments.
40. In addition, such a consideration would not appear to be consistent with the themes that emerged from the public round tables, namely that a comprehensive approach to the reporting for financial instruments should be

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developed jointly by the IASB and FASB as a matter of urgency, and that attempting accelerated efforts in complex areas (especially short-term changes that attempt to create a ‘level playing field’) can have unintended consequences and undermine investor confidence in financial reporting.