IFRS Briefing Sheet

Publication of Amendments to IAS 39 *Financial Instruments: Recognition and Measurement* – Transition and Initial Recognition of Financial Assets and Financial Liabilities

Issue 15

This *IFRS Briefing Sheet* discusses the International Accounting Standards Board's (IASB's) recent publication of Amendments to IAS 39 *Financial Instruments: Recognition and Measurement* – Transition and Initial Recognition of Financial Assets and Financial Liabilities, which was issued on 17 December 2004. The amendments provide alternative transition dates from the requirement for full retrospective application of the 'day one' gain and loss recognition requirements. The amendment also provides some additional guidance on subsequent measurement of these gains and losses.

Background

Some entities have recognised 'day one' gains and losses upon issuing or acquiring financial instruments. A 'day one' gain or loss is the difference between the amount paid (or received) upon acquiring (or issuing) a financial instrument and the fair value of that instrument at the date it is issued (or acquires). Entities have argued that they are capturing arbitrage differences between markets (e.g., institutional and retail). Revised IAS 39 describes the circumstances when an entity can recognise 'day one' gains or losses from issuing or acquiring a financial instrument.

IAS 39 requires that financial assets and financial liabilities be measured at fair value upon initial recognition. Revised IAS 39 included application guidance regarding determining the fair value of financial instruments for which there is no active market. This guidance indicates that the best evidence of the fair value of a financial instrument at initial recognition is the transaction price. This presumption can be overcome if evidence of the fair value of that instrument is provided by comparison with other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable markets. It follows that a 'day one' gain or loss can be recognised only if this kind of market evidence is available.

The revised IAS 39 originally required retrospective application of 'day one' gain or loss recognition requirements. After revised IAS 39 was published in December 2003, the IASB was told that retrospective application of these requirements would be difficult to implement and would require additional subjective assumptions. It also would diverge from the transition provisions and effective date of similar U.S. GAAP requirements.

A supplement to KPMG's publication IFRS in Brief

Amendments

The transition requirements in the revised IAS 39 were amended to permit entities to apply the 'day one' gain or loss recognition requirements in IAS 39 either:

- **retrospectively** (as previously required by IAS 39);
- **prospectively** to transactions entered into after 25 October 2002 (the effective date of similar requirements in U.S. GAAP); or
- **prospectively** to transactions entered into after 1 January 2004 (the date of transition to IFRSs for many entities).

Additional guidance is provided on income recognition of previously deferred 'day one' profit, to emphasise that it should be recognised only to the extent that it arises from a change in a factor (including time), that market participants would consider in setting a price.

Effective date and transition

The amendments should be applied for annual periods beginning on or after 1 January 2005. An entity should apply the amendments to an earlier period when it applies IAS 39 and IAS 32 *Financial Instruments: Disclosure and Presentation* to that period.

If you would like further information on any of the matters discussed in this issue of *IFRS Briefing Sheet*, please talk to your usual local KPMG contact or call any of our member firms' offices.

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