One fewer non-GAAP adjustment to worry about: improvements to the accounting for changes in own credit

Patricia McConnell, a member of the IASB, provides her perspectives on the IASB's changes to accounting for own credit

The own-credit gain or loss is one of the most common adjustments made to profit and loss in deriving non-GAAP measures. This accounting change means that this adjustment will no longer be necessary for companies that choose to take early advantage of it. This should be good news to the investment community.

Many investors and analysts will be happy to hear that gains and losses resulting from changes in a company's own credit may now be excluded from profit and loss under IFRS. Own-credit gains and losses are the accounting effect of changes in an issuer's creditworthiness when it remeasures its own debt at fair value. Because an issuer's creditworthiness affects the fair value of its debt, when its credit risk increases, if its debt is measured at fair value, its debt declines, resulting in the appearance of a gain. In the past, and especially during the recent credit crisis, this gain, which was often substantial, was recognised in profit and loss.

Many found this accounting result counterintuitive, confusing and less than useful. In response to these concerns, the IASB changed the treatment of own-credit gains and losses. Companies may now put the own-credit gain or loss in other comprehensive income (OCI), thus reducing profit and loss volatility from changes in their own credit. The remaining change in the fair value of a company's debt (eg from changes in the general level of interest rates) will continue to be reported in profit and loss. The change in reporting of own-credit gains and losses may be made in isolation and does not require a change in any other aspect of the company's financial instrument accounting until 2018 when IFRS 9 *Financial Instruments* becomes effective[1].

Profit and loss volatility will no longer result from changes in own credit.

The vast majority of a company's liabilities will be at amortised cost. The ability to use the fair value option remains the same. All liabilities that a company chooses to measure at fair value under the fair value option will continue to be on the balance sheet at fair value. Importantly, the current election to measure structured debt at fair value or to split it into a 'vanilla' debt instrument measured at amortised cost and a derivative measured at fair value will also remain in place. If the liability is split, the whole change in the fair value of the derivative will continue to be reported in profit and loss. As a result, those who prefer to bifurcate complex financial liabilities rather than carry the whole instrument at fair value can continue to do so.

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[1] Because IFRS 9 requires other changes to accounting for financial instruments and is not mandatory until 2018, in November 2013 the IASB decided to *allow* companies an option to adopt the own-credit provisions early (prior to 2018). An entity will be *required* to report own-credit gains and losses through other comprehensive income once the final version of IFRS 9 is effective.

Respond to the author

Patricia McConnell is a member of the IASB. The views expressed in this article are those of the author and do not necessarily reflect the views of the IASB or the IFRS Foundation. The IASB/IFRS Foundation encourages its members and staff to express their individual views. This article has been developed by the author as an individual. It is has not been subjected to any due process of the IASB/IFRS Foundation. Official positions of the IASB/IFRS Foundation are determined only after extensive due process.

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