The voice of banking
& financial services

Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
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21 October 2011

Dear Mr Hoogervorst,

ED/2011/3: Mandatory Effective Date of IFRS 9

We write with reference to the above exposure draft, we welcome the opportunity to comment on this important issue for financial institutions.

Given the slower than expected pace of the project to replace IAS 39 we believe it is wholly appropriate to review the effective date for IFRS 9. We would not, however, support a decision to replace the 1 January 2013 deadline with one set at 1 January 2015. This would seem too short a timeframe given the work that remains to be done before the revision of IAS 39 will be complete.

The priority, in our view, is to provide sufficient time for the standard to be revised and for reporting entities to prepare for what amounts to a substantial reordering of their balance sheet. The decision of the European Commission not to consider the endorsement of IFRS 9 until such time as the full project is delivered only goes to reinforce the case in favour of delaying the current effective date for IFRS 9, as does any realistic evaluation of the time it will take to develop high quality standards relating to impairment and hedging. As an alternative, we propose instead that the Board consider adopting an effective date of 1 January 2016 but with a precondition that even this date will be re-evaluated should the impairment and hedging parts of the project not be delivered by mid-2012. Should the projects related to impairment and hedging take longer than this to be delivered then we believe the Board should reassess the effective date in light of the full facts at this time. The Board should publish, as a matter of urgency, a project plan which sets out a realistic timeline for the completion of the project.

Should the IAS 39 review project be completed in 2012 then a 1 January 2016 deadline would give entities a three year period in which to prepare for adoption. This would mirror the transition period envisaged by the original standard and would permit, subject to the successful to conclusion of the projects, the effective date to be linked to that for the insurance and leases projects – an important consideration given the need to minimise the volatility of financial statements which will result in the adoption of these three fundamental projects. A single effective date will go some way towards mitigating this issue. We would urge the IASB to issue project plans, including detailed timelines, for the completion of the insurance and leases standards to allow preparers and users to understand the likely timing of future changes.

If the Board wishes to take an interim step towards improving the financial reporting of financial instruments then we would recommend it considers amending the treatment of fair value changes arising from changes in own credit for non-derivative financial liabilities in IAS 39 *Financial Instruments: Recognition and Measurement*. We remain of the view that the implementation of this

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uncontroversial change would be a significant step towards enhancing the quality and reputation of IFRS.

In terms of transition, we question the Board's decision not to maintain the original relief related to the restatement of comparatives as we do not consider it is practicable to expect entities to apply IFRS 9 on a retrospective basis in the absence of this relief. The Board will be fully aware that the standard requires decisions related to fair value and the business model to be made at the date the standard is first applied and that it is not possible to make these decisions for instruments which have been derecognised prior to that date. The resultant requirement to retain in comparators the IAS 39 classification for these instruments is impracticable given the burden it will place on entities to maintain otherwise redundant systems - for up to four years in the case of SEC registrants - and will result in the provision of information that is not useful and is potentially misleading to users given that the comparatives will be a mix of IAS 39 and IFRS 9. As such, we believe the Board should adopt a transition approach consistent with that for IAS 39, IAS 32 and IFRS 4 in 2005, under which IFRS 9 would be applied on a retrospective basis with the opening balance sheet for the current period restated but with relief from the requirement to provide comparatives. In our view, this would provide better information to users than comparatives which are not comparable to the results under either IAS 39 or under IFRS 9.

We offer our responses to the questions below.

Question 1:
The Board proposes to amend IFRS 9 (2009) and IFRS 9 (2010) so that entities would be required to apply them for annual periods beginning on or after 1 January 2015. Do you agree? Why or why not? If not, what alternative do you propose?

Whilst we support the Board's decision to amend the mandatory effective date for the application of IFRS 9, we do not support the proposition that the new effective date should be set at 1 January 2015 and propose instead that the Board should adopt 1 January 2016 as an alternative, with the precondition that satisfactory progress is made towards the delivery of the complete high-quality replacement for IAS 39 by mid 2012. If it is not, the Board should move to reconsider the effective date once again. We believe that this approach represents the best compromise between setting a delivery date for the project, which reflects the complexity of the project, and the need to allow preparers sufficient time to implement the new requirements; we note that the 1 January 2013 effective date effectively gave preparers three years when the standard was originally approved in late 2009.

Given the substantial changes that the new standards will entail, we would urge the Board to link the effective date for IFRS 9 and the remainder of the IAS 39 project to that for the insurance and leases standard, as long as doing so does not result in further significant delay to improvements in financial reporting. Detailed project plans should be published for all three standards to assist preparers and users to understand more fully the current status of the project and the anticipated delivery timetables. Aligning the effective dates will not only lessen the burden on preparers but will also minimise the volatility of financial statements during the transition.

If the Board wishes to take an interim step towards improving the quality of financial instruments then we would recommend it considers amending the treatment of fair value changes arising from changes in own credit for non-derivative financial liabilities in IAS 39 *Financial Instruments: Recognition and Measurement*. We remain of the view that the implementation of this uncontroversial change would be a significant step towards enhancing the quality and reputation of IFRS.

We outline our view of the appropriate transition arrangements below.

Question 2:
The Board proposed not to change the requirement in IFRS 9 for comparatives to be presented for entities that initially apply IFRS 9 for reporting periods beginning on or after 1 January 2012. Do you agree? Why or why not? If not, what alternative do you propose?

We disagree with the Board's decision and urge that this issue be reconsidered. In our view, it is not possible to apply IFRS 9 on a retrospective basis with restated comparatives since the standard requires certain decisions (fair value option and business model) to be made at the date the standard is first applied and it is not possible to apply these decisions to financial assets and liabilities that have been derecognised prior to that date. We note that to overcome this issue the standard intends that financial assets and liabilities that have been derecognised should retain their IAS 39 classification and measurement in restated comparatives.

In our view, retaining IAS 39 classification and measurement would require tracking individual disposals over four years (in order to meet the obligations of SEC registrants). In our opinion, the costs and efforts involved in this cannot meet any reasonable cost/benefit test, particularly as the restated comparatives will be a mix of IAS 39 and IFRS 9 and therefore not be comparable. The situation will only become more complex when the impairment provisions also need to be applied and changes to hedge accounting are applied prospectively.

The only practicable way of applying IFRS 9 on a retrospective basis is therefore to restate the opening balance sheet for the current period in accordance with the final transitional provisions in the standard and not restate comparative periods (consistent with the method applied to IAS 39, IAS 32 *Financial Instruments: Presentation* and IFRS 4 *Insurance contracts* in 2005). The Board could also require additional transition disclosures, similar to those that many European entities used in 2005. In our view this would also result in the provision of more useful information than the comparatives that result from the application of the requirements in IFRS 9. We also note that the Board should address the possible effect of IAS 8.28(f). This is an issue addressed in more detail in our response to the Annual Improvements ED (ED2011/2).

We set out further thoughts on the merits of prospective and retrospective application of standards in the Annex.

Please do not hesitate to contact me if you require any further information on any of the issues raised in this letter.

Yours sincerely,

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Executive Director

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Definitions of Prospective Application and Retrospective Application

Issue

Some of the new accounting standards which are required to be applied from 1 January 2013 state they should be applied prospectively or retrospectively and some refer to IAS 8. IAS 8 requires voluntary changes in accounting policy to be applied retrospectively and new accounting standards to be applied in accordance with their transitional provisions, or retrospectively if there are no transitional provisions.

It is possible to apply a new accounting standard retrospectively with or without restating comparative periods, depending on the date of the opening balance sheet to which the new requirements are first applied. Therefore it is important for the terminology used clearly and consistently.

Definitions

<u>Prospective application</u>

Where a new accounting standard is applied prospectively, the new accounting policy is applied to transactions that occur after the date of the change in policy (which is often the start of the current period) and the effect of any change in accounting measurement is recognised in the accounting period where the change is made (which is often the current period) and may continue to impact any future periods effected.

For example, any changes to fair value measurement as a result of applying IFRS 13 will first affect fair value measurements after 1.1.13 and will impact net income or OCI in periods after 1.1.13.

<u>Retrospective application</u>

Where a new standard is applied retrospectively, an opening balance sheet is prepared which adjusts the previous closing balance sheet to the balances which would have resulted as if the new accounting policy had always been applied. The new accounting policy is then applied for subsequent accounting periods. If the adjusted opening balance sheet is for the start of a comparative period, then comparatives will be restated. If the adjusted opening balance sheet is for the start of the current period, then comparatives will not be restated. Nevertheless, the standard would be applied retrospectively if the opening balance sheet is restated as if the new standard had always been applied.

There are few examples of full retrospective application of a new accounting standard in current IFRS – there are generally some transitional provisions which limit the extent of retrospection.

An example of retrospective application without restatement of comparatives is the transition to IAS 32, 39 and IFRS 4 in 2005 where the opening balance sheet as at 1.1.05 was prepared as if the standards had always been applied but comparative periods were not restated.

Similarly, in the US SFAS 167 was applied to the opening balance sheets at 1.1.10 but comparatives were not restated.

<u>IFRS 9</u>

The IFRS 9 transitional provisions and requirements for restated comparatives are the subject of a recent exposure draft.

It is not possible to apply IFRS 9 on a retrospective basis since the standard requires certain decisions (fair value option and business model) to be made at the date the standard is first applied and it is not possible to apply these decisions to financial assets and liabilities that have been derecognised prior to that date. Therefore the standard intends that financial assets and liabilities that have been derecognised will retain their IAS 39 classification and measurement in restated comparatives.

In our view, retaining IAS 39 classification and measurement would require tracking individual disposals over four years (in order to meet SEC requirements). The costs and efforts involved in this cannot meet any reasonable cost/benefit test, particularly as the restated comparatives will be a mix of IAS 39 and IFRS 9 and therefore not be comparable. The situation will only become more complex when the impairment provisions also need to be applied.

The only practicable way of applying IFRS 9 on a retrospective basis is to restate the opening balance sheet for the current period in accordance with the final transitional provisions in the standard and not restate comparative periods. This would be consistent with the method applied to IAS 39, IAS 32 and IFRS 4 in 2005.