30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
E-mail: iasb@iasb.org Website: www.iasb.org

International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting: **19 June 2008, London**

Project: **IAS 39 *Financial Instruments: Recognition and Measurement, Eligible Hedged Items***

Subject: **Transition requirements for the proposed amendments *Eligible Hedged Items* (Agenda paper 7E)**

BACKGROUND

1. In May 2008 the Board discussed transition requirements for the proposed amendments to IAS 39 relating to eligible hedged items (the 'portions' amendment). The Board decided that the proposed amendments should be applied retrospectively.
2. The Board reached this decision for reasons that include:
   a) That is the principle set out in IAS 8 *Accounting policies, Changes in Accounting Estimates and Errors*, and in the situations addressed by the proposed amendments it is practicable to retrospectively apply the proposed amendments (many, if not most, entities will not be required to do anything).
   b) The proposed amendments do not change the requirements of IAS 39, but provide some additional guidance as to how to apply the principles behind hedge accounting in two specific situations.
3. Some respondents to the ED urged the Board to not require retrospective application. The arguments advanced were set out in paper 10C (May 2008), and the transition options available to the Board were also described in that paper.

4. This paper does not revisit those arguments. It is also not the intention of the staff that the Board re-debate those arguments.
5. However some constituents have raised two other points that the staff believe should be bought to the Board's attention before the proposed amendments are finalised. The two points are:
   a) The transition implications for any changes in hedge accounting requirements in the future (for example, as a result of the discussion paper *Reducing Complexity in Reporting Financial Instruments)*. Or, put another way, if the Board changes the hedge accounting model in the future, will the Board require retrospective application.
   b) The transition requirements of the IFRIC Interpretation *Hedges of a Net Investment in a Foreign Operation* (previously D22). That Interpretation requires (subject to ratification of the Board) prospective application.
6. Of course, the concerns raised by some are the consequences arising from the inability to designate a hedge accounting relationship retrospectively. No-one is suggesting that the Board permit retrospective designation of hedge accounting designations. However, the concerns are that hedge designations that complied with the accounting requirements at the time they were made might be required (as a result of a subsequent change in those accounting requirements) to be reversed. And of course an entity is never able to designate another hedge accounting relationship for that comparative period.
7. To address these points, the staff believes the Board should determine the transition requirements for amendments to hedge accounting literature that reflect the nature of the amendment – that is, whether the amendments change existing (or create new) requirements or not.

AMENDMENTS THAT CHANGE EXISTING REQUIREMENTS OR CREATE NEW REQUIREMENTS

8. When requirements have been changed the Board has not required retrospective application. For example, the amendments to IAS 39 *Cash Flow Hedge Accounting of Forecast Intragroup Transactions* allowed an entity to designate a foreign currency denominated forecast intragroup transaction as the hedged item in consolidated financial statements in a cash flow hedge in particular situations. IAS 39 (as amended in December 2003) did not allow this, despite the fact it was common practice (and was permitted in the previous version of IAS 39). That amendment permitted but did not

require retrospective application. (Retrospective application was permitted only for hedge accounting designations that had been put in place in anticipation of the amendment.)

9. Likewise, paragraph 30 of IFRS 1 *First-time Adoption of International Financial Reporting Standards* requires an entity to discontinue hedge accounting prospectively, if previously designated (under national GAAP) hedge accounting relationships do not meet the conditions for hedge accounting in IAS 39. Retrospective application of the requirement relating to (for example) the requirement in IAS 39 that a forecast transaction be highly probable to be eligible for cash flow hedge accounting were not allowed to be retrospectively applied (see paragraph IG60B).

10. The Interpretation *Hedges of a Net Investment in a Foreign Operation* requires prospective application. It is clear from the length of the Interpretation, the time taken to develop it and the extensive discussion of a wide range of issues in the Basis that the Interpretation actually sets out **the** (or new) requirements for hedges of net investments. While the Interpretation is clearly derived from existing hedge accounting principles, they are few requirements relating specifically to hedges of net investments set out in IFRS today. That is, the Interpretation is effectively a 'mini-standard'.

NO CHANGE TO EXISTING REQUIREMENTS

11. The objective of the ED *Exposures Qualifying for Hedge Accounting* was to clarify the Board's original intentions, not to change existing requirements (see paragraph BC 2 of that ED).

12. Likewise, the approach chosen by the Board for the final amendment (to provide additional application guidance illustrating how to apply the principles to two particular situations) will not change existing requirements. Rather, it is intended to eliminate the diversity in application of those principles that exists today or may exist in the future.

CONCLUSION

13. Historically, the Board has not required (or permitted) retrospective application if the hedge accounting requirements have been changed or if new requirements added. This is primarily because of the restriction on designating a hedge accounting relationship retrospectively. It is unlikely that a different approach would be adopted in such situations in the future.

14. Historically, the Board has also set out transition requirements that reflect the nature of the amendment, standard or interpretation. The staff believes that the proposed transition requirements for both the Interpretation *Hedges of a Net Investment in a Foreign Operation* and the proposed amendments to IAS 39 *Eligible Hedged Items* are consistent with the past approach. The staff believes that they reflect the different nature of the Interpretation and amendment. If the Board does not agree, the staff recommends that the Board change the transition requirements of one of the documents.

Questions to the Board

Does the Board agree that the nature of an amendment, standard or interpretation relating to hedge accounting should determine the transition requirements? Does the Board agree with the staff's conclusion that the nature of the changes made by the two forthcoming documents is different? If the Board does not agree with the staff's conclusion, which transition requirements (the Interpretation *Hedges of a Net Investment in a Foreign Operation* or the proposed amendments to IAS 39 *Eligible Hedged Items)* should be changed, and how?