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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting:	**20 May 2008, London**
Project:	***IAS 39 Financial Instruments: Recognition and Measurement*, Exposures Qualifying for Hedge Accounting (ED)**
Subject:	**Effective date and transition requirements for the proposed amendments (Agenda paper 10C)**

INTRODUCTION

1. This paper addresses the transition requirements for the proposed amendments. This paper sets out:
    a) the background
    b) the staff's recommendation
    c) an analysis of the issues, including consideration of comments by respondents to the ED.

BACKGROUND

2. The ED proposed retrospective application. As stated in paragraph BC 15 of the ED, the Board believed that restating comparative information on first-time application of this proposed amendment should not entail significant cost or effort because the requirement in IAS 39 to document hedging relationships should mean that the information required to make any restatement is readily available.

STAFF RECOMMENDATION

3. The staff recommends that the proposed amendments be applied retrospectively.

4. The staff also recommends that the proposed amendments be applied for annual periods beginning on or after 1 January 2009, with earlier application permitted.

STAFF ANALYSIS

5. Many respondents to the ED believe that the requirement to apply the proposed changes retrospectively is inappropriate. The main reasons given include that such a requirement is:
   a) inconsistent with hedge accounting principles of IAS 39 which requires formal designation and documentation at inception of the hedging relationship. Some respondents believe that since formal designation and documentation is required at inception, hedging relationships cannot be retrospectively applied. Furthermore, a requirement to restate financial statements and perform ongoing effectiveness calculations both retrospectively and prospectively creates costs for preparers.
   b) inconsistent with transition requirements of other amendments to hedge accounting (for example, amendments to IAS 39 *Cash Flow Hedge Accounting of Forecast Intragroup Transactions*). These amendments only required limited retrospective application.
   c) a source of reduced comparability between entities.

6. Respondents that disagreed with retrospective application requested the Board consider the following alternatives as a more practical and efficient approach:
   a) prospective application
   b) limited retrospective application
   c) transition provisions similar to those proposed in paragraph 29 of IFRS 1 *First-time Adoption of International Financial Reporting Standards.* (The staff notes that this approach appears to be similar to prospective application, but is unclear how it would apply in the context of the proposed amendments.)

7. The remainder of this paper addresses issues raised by respondents in paragraph 5.

Staff comments- retrospective application is inconsistent with hedge accounting principles of IAS 39

8. The staff agrees that prospective designation and documentation of hedge accounting relationships is required by IAS 39. However, the staff believes that has little to do with a requirement of retrospective application.

9. Retrospective application (as set out in IAS 8 *Accounting policies, Changes in Accounting Estimates and Errors*) is applying an accounting policy for prior periods as if the new accounting policy had always been applied. Retrospective application would not allow an entity to make retrospective hedge accounting designations, but instead would require an entity to apply the proposed amendments as if they had always applied them.

10. Although the Board believes that the proposed amendments simply clarify their original intentions, the Board has also acknowledged that the accounting of some entities may be affected (particularly with regard to option hedge accounting). That is, some entities will be required to restate hedge accounting relationships that do not qualify. Given the original hedge accounting documentation, such a restatement should not be impracticable. Furthermore, in the staff's view, it would be inappropriate to permit an entity to make a retrospective hedge accounting designation to 'correct' a previous designation; that is not permitted today in any situation because prospective hedge accounting designation is a fundamental requirement underpinning the disciplined application of hedge accounting. (Also see later comments on increased comparability to users of financial statements).

Staff comments- inconsistent with previous hedge accounting amendments

11. A previous amendment to IAS 39 *Cash Flow Hedge Accounting of Forecast Intragroup Transactions* required limited retrospective application only. However, that amendment changed the requirements of IAS 39. The proposed amendments do not change the requirements of IAS 39, although they may change practice in some situations. Therefore, in the view of the staff, the two amendments served a different purpose, and the transition requirements of one should not be analogised to.

Staff comments- reduced comparability between entities

12. The Basis for Conclusions to IAS 8 argues that retrospective application is preferable to other treatments because it provides the most useful information to users of financial statements.

13. Today there is diversity in practice (particularly with regard to option hedging). The objective of the Board in making the proposed limited amendments is to eliminate that diversity in practice. Eliminating that diversity in practice will improve comparability in the future. Retrospective application will also improve comparability (in terms of accounting policies applied) for prior periods.

14. Some respondents to the ED argued that any amendments should allow them to retrospectively designate hedge accounting relationships that would no longer qualify under paragraph AG99E. The hedging instrument (option) would be designated for intrinsic value only. It was argued that such an approach would improve comparability for prior periods.

15. As discussed previously, the staff believes that the retrospective designation of hedge accounting relationships should never be permitted. The staff also notes that hedge accounting is optional, anyway, and so it is arguable whether the treatment suggested in the previous paragraph would improve the comparability of prior period information between entities (note, however, that the staff believes that retrospective application does improve the comparability of *accounting policies* in this situation, as discussed previously).

Questions to the Board

Does the Board agree with the staff recommendations set out in paragraphs 3 and 4? If not, what does the Board wish to do, and why?