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Project	<b>Financial Instruments (Replacement of IAS 39) – Hedge Accounting</b>
Topic	<b>Transitional Provisions</b>

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## Introduction

### *Background*

1. This paper addresses transition.

### *Purpose of the paper*

2. This paper provides an analysis of the alternative transition approaches available. The staff provide the Board with the pros and cons of each one of the alternatives.
3. This paper has the following structure:
  - (a) overview of the issue;
  - (b) staff analysis; and
  - (c) staff recommendation and questions to the Board.

## The issue

4. Which transition proposals should be included in the forthcoming exposure draft on hedge accounting?
5. The staff notes the recent publication of the Request for Views *Effective Dates and Transition Methods*. The staff would expect that the Board will take into consideration comments received on that document along with any transition

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This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in *IASB Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, Firs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

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proposals in the forthcoming exposure draft on hedge accounting in deciding any final transition requirements.

**Staff analysis and alternatives*****Transition requirements in IAS 8***

6. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* states that retrospective application results in the most useful information to users. IAS 8<sup>1</sup> also states that retrospective application shall be the preferred approach to transition unless such retrospective application is impracticable. In such scenario the entity shall adjust the comparative information to the earliest date practicable.
7. Consistent with that, IFRS 9 *Financial Instruments* requires retrospective application (with some relief in particular circumstances).
8. The proposed hedge accounting model would represent a significant change from current requirements in some areas. For example:
  - (a) A stronger link to risk management as one of the qualifying criteria;
  - (b) The removal of the bright-line for the effectiveness assessment testing. The proposed model relies on an objective-based effectiveness assessment testing;
  - (c) New eligibility criteria both for hedged items and hedging instruments including groups and net positions;
  - (d) New provisions for discontinuation, redesignation and rebalancing.
9. However, under the proposals, a hedge accounting relationship can only be designated prospectively. Like today. This fact means that, as in previous amendments and changes to hedge accounting requirements, retrospective application is not applicable.

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<sup>1</sup> IAS 8 paragraph 23-28

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10. Hence, the staff believes that the Board has two alternatives in relation to the transitional provisions for the new exposure draft on hedge accounting:
  - (a) **Alternative 1** – Prospective application for *new* hedging relationships only
  - (b) **Alternative 2** – Prospective application for *all* hedging relationships

***Alternative 1 – Prospective Application for new hedging relationships only***

11. Prospective application is the scenario where the Board would require the application of the proposed hedge accounting model for *new* hedging relationships after the adoption date.
12. Such an approach would mean that the current model in IAS 39 will need to be maintained until the hedging relationships established under IAS 39 are terminated, dedesignated or otherwise the hedge accounting designation is removed.
13. Under this approach, the new disclosures specifically designed for hedge accounting will only be presented for the hedging relationships accounted for under the proposed model.
14. This approach entails the complexity of applying the two models simultaneously and also a set of disclosures that will be inconsistent and difficult to interpret.
15. In addition, for long term hedges that entities choose not to dedesignate, the current model will need to be maintained until all those hedges fail the qualifying criteria under the old model or are otherwise dedesignated at a later point.
16. Taking the arguments outlined above, the staff believes that prospective application of the proposed hedge accounting model to new hedging relationships only will increase complexity, and will not provide a set of meaningful information as a result of different disclosure requirements.

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Therefore applying this alternative to transition will be in our view inappropriate.

***Alternative 2– Prospective Application to all hedging relationships***

17. A prospective application to all hedging relationships would resolve the issue of applying two models simultaneously.
18. Under this option, the Board would allow some one-off transitional provisions to ensure that ‘qualifying’ hedging relationships are transitioned from the existing model to the newly proposed model and will therefore be subject to the provisions within the proposed model from the adoption date. This includes presentation and disclosure.
19. In relation to the issue of qualifying hedges the staff believes the Board should require an entity to assess whether hedging relationships are eligible for hedge accounting under the new model at the transition date. This will include hedging relationships that had been eligible under IAS 39.
20. For fair value hedge accounting relationships that were eligible under IAS 39, and continue to be eligible under IFRS 9, the issue of presentation also needs to be considered.
21. Under IAS 39, the item being hedged is adjusted for the hedged risk, with both that hedge adjustment and the fair value change of the hedging instruments being presented in profit or loss.
22. For fair value hedge accounting relationships that were eligible under IAS 39, and continue to be eligible under IFRS 9, the separate presentation of the cumulative hedge adjustments should be required for the entire life of the hedge. This will require an entity to present the cumulative hedge adjustments that had, under IAS 39, been made to the hedged item and present them as part of the separate hedge adjustment line item. This will inevitably involve some administrative burden. However, given the tracking requirements in IAS 39 for ongoing hedges we believe that this should be possible. This would then ensure

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that the separate hedge adjustment line item includes the effects of all ongoing hedging relationships after adoption of any new requirements.

***Discontinuation or continuation of an existing hedging relationship***

23. If at the transition date the Board decides to choose the option described in paragraph 18 and 19, one of the issues that the Board needs to address is whether the transitioned hedging relationships are new hedges (as a result of a discontinuation and restart event) or alternatively are a continuation of an existing hedge.
24. In our view upon transition hedging relationships that meet the qualifying criteria under the newly proposed hedge accounting model should be considered a continuation of an existing hedge. This is consistent with the proposed model because if the risk management intention has not changed and all the qualifying criteria are still met then there is no discontinuation event.

***IFRS 1***

25. For first time adopters, entities need to look at the entire population of possible hedging relationships as defined by risk management and assess which ones are in compliance with the qualifying criteria in accordance with the new model. These shall be documented on or prior to the transition date.
26. This approach is consistent with the approach set out above for existing users of IFRS, as well as the current transition rules in IFRS 1<sup>2</sup> which require that if ‘an entity had designated a transaction as a hedge but the hedge does not meet the qualifying criteria in IAS 39 the entity shall discontinue hedge accounting’.
27. This also means that the provisions in IFRS 1 will not be subject to change. This would include retaining the guidance in paragraphs IG 60 – 60B (prospective

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<sup>2</sup> Refer to paragraphs B5 and B6 of Appendix B to IFRS 1

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documentation, designation and treatment of deferred amounts on previous GAAP hedges)

28. Any differences arising from the first time adoption of the new hedge accounting model shall be presented in retained earnings as required by paragraph 11 of IFRS 1.

**Effective date**

29. Consistent with the effective date for IFRS 9 the staff proposes an effective date for accounting periods beginning on or after 1 January 2013. Earlier application shall be permitted. However, consistent with earlier decisions, entities will only be able to apply the provisions within the hedge accounting standard if they adopt all the finalised IFRS 9 requirements that preceded finalisation of the hedge accounting phase.

**Staff Conclusion**

30. Based on the arguments outlined above the staff's conclusion on the transition provisions for the new hedging model is as follows:
- (a) Application of the new hedge accounting requirements should be prospective;
  - (b) Comparative figures shall not be restated;
  - (c) All possible hedging relationships shall be assessed at the date of adoption for qualification using the new criteria
  - (d) IAS 39 hedge accounting relationships that qualify under the proposed model shall be regarded as continuing hedges and therefore there shall be no discontinuation and restart. Conversely IAS 39 hedge accounting relationships that do not qualify under the new model shall be subject to the accounting guidance on discontinuation.
  - (e) There shall be no changes to the transition provisions in IFRS 1.

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- (f) The proposed effective date shall be for annual periods beginning on or after 1 January 2013 with earlier application permitted. The staff will provide the Board with the input received from the consultation document on effective dates for convergence accounting standards at the time of redeliberations.
- (g) The hedge accounting requirements of IFRS 9 can only be applied if all the finalised IFRS 9 requirements that preceded finalisation of the hedge accounting phase are or have been adopted.

**Staff recommendations and questions to the Board.**

31. Refer to paragraph 29 above.

**Question - Accounting for discontinued fair value hedges**

- a) Does the Board agree with the staff recommendation as outlined in paragraph 31?
- b) If the Board disagrees with the staff recommendation, how does the Board want to proceed, and why?