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IAS 39 – the sequel.

Time for new measures

Background

On 14 July 2009, the International Accounting Standards Board (IASB) issued an exposure draft (ED), ED/2009/7, *Financial Instruments: Classification and Measurement*. The ED is part of a series of exposure drafts the IASB is planning to issue during the course of 2009 that is intended to ultimately replace IAS 39 *Financial Instruments: Recognition and Measurement*. The objective of the ED is to improve the decision-usefulness of financial statements for users by simplifying the classification and measurement requirements for financial instruments (both financial assets and financial liabilities).

The impetus for changing financial instrument accounting originates from a number of sources. Many constituents have urged the IASB to develop a replacement to IAS 39 that is more principle-based and less complex. Since 2005, the IASB and the US Financial Accounting Standards Board (FASB) have had a long-term objective to improve and simplify the reporting of financial instruments. In March 2008, the Boards published a discussion paper, *Reducing Complexity in Reporting Financial Instruments*, with the recommendations and suggestions provided by constituents used in the development of the classification and measurement ED.

In April 2009, the Boards announced an accelerated timetable for replacing their respective financial instrument standards in response to conclusions of the G20 leaders and the recommendations of international bodies such as the Financial Stability Board.

The headlines

- New criteria for amortised cost measurement.
- New measurement category – fair value through other comprehensive income.
- Impairment assessment only for amortised cost assets.
- No more available-for-sale assets.
- No more held-to-maturity assets and tainting rules.
- No more reclassifications between categories.
- No more separation of embedded derivatives in financial instruments.
- No more unquoted equity investments measured at cost less impairment.

IAS 39 components

	Classification and measurement	Derecognition	Impairment	Hedge accounting
Q1 2009		Exposure draft		
Q2 2009			Request for information	
Q3 2009	Exposure draft			
Q4 2009	Final standard		Exposure draft	Exposure draft
H1 2010		Final standard	Final standard	
H2 2010				Final standard
2012	Mandatory application of full standard			

In addition, the ED also reflects the discussions to date of the Financial Crisis Advisory Group on how improvements in financial reporting could help enhance investor confidence in financial markets.

The project to replace IAS 39 has been divided into sections. The sections of the project as illustrated in the diagram at the bottom of page one are as follows:

- Classification and measurement. The July 2009 ED discussed in this newsletter contains proposals in this area. The Board expects to finalise this phase in time to allow, but not require, early application for 2009 year end financial statements.

- Derecognition. In March 2009 an ED proposed changes to IAS 39 in the area of derecognition of financial instruments. The final standard in this area is expected in the first half of 2010.

- Impairment methodology. In June 2009 the IASB published a Request for Information on the feasibility of an expected loss model for the impairment of financial assets. The input will assist the IASB in developing an ED that it plans to publish in the fourth quarter of 2009. The final standard in this area is expected in the first half of 2010.

- Hedge accounting. The Board intends to issue an exposure draft on hedge accounting in the fourth quarter of 2009 with the intention of issuing a final standard in the second half of 2010.

The IASB's intention is that a replacement to IAS 39, capturing all the above work streams, will be mandatory no earlier than January 2012.

New classification rules and measurement categories

The ED proposes reducing the number of measurement categories to three:

- Amortised cost (for some debt instruments).

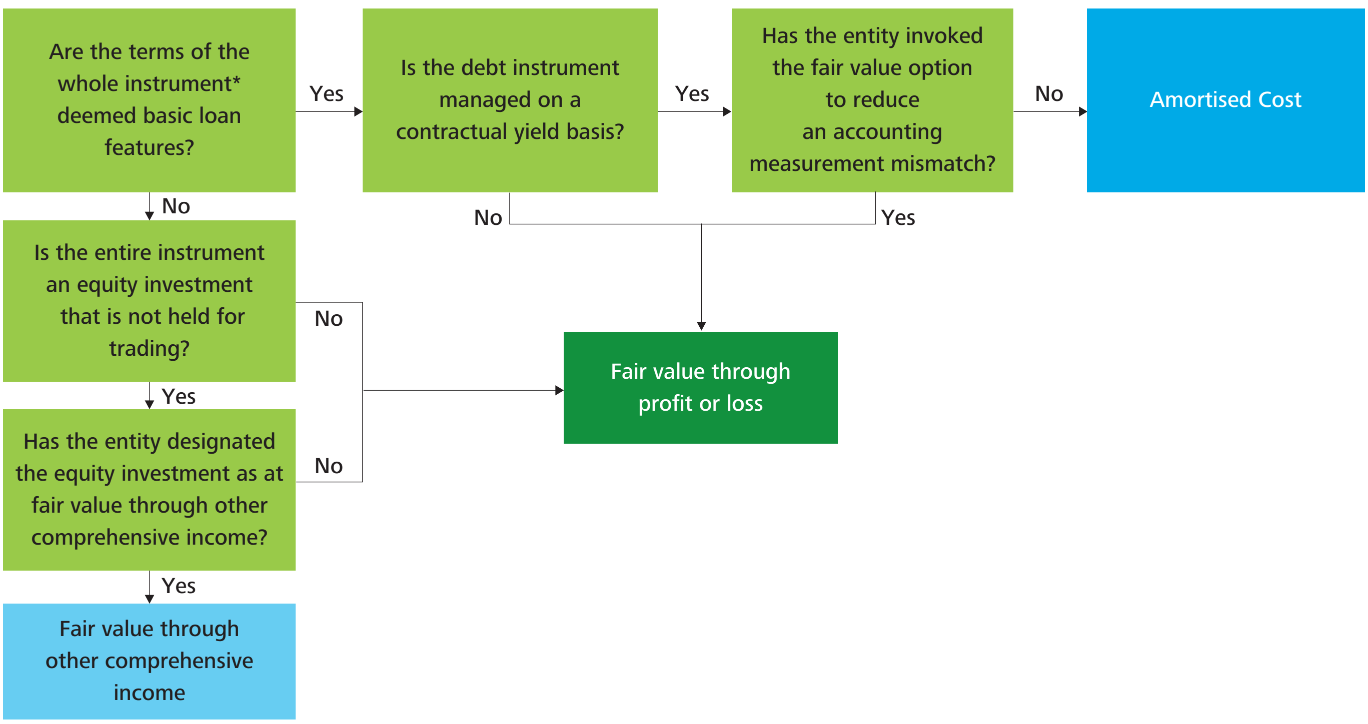
- Fair value through profit or loss (for some debt instruments and some equity investments).

- Fair value through other comprehensive income (for some equity investments).

Under the current standard there are four categories for financial assets: fair value through profit or loss, available-for-sale, loan and receivable, held-to-maturity, and two categories for financial liabilities: amortised cost and fair value through profit or loss.

The current standard permits and in some cases requires reclassifications between measurement categories. The ED does not permit any reclassifications out of or into amortised cost, fair value through profit or loss (FVTPL) or fair value through other comprehensive income (FVTOCI).

The flowchart below summarises the new classification proposal for non-derivative financial instruments. Derivatives, as in the current standard, continue to be measured at fair value through profit or loss.



* The whole instrument also includes the non-derivative liability component of a compound instrument where the equity component is recognised in Equity by the issuer under IAS 32 *Financial Instruments: Presentation*

The impact of the proposals is discussed below by considering their application to three different types of financial instruments:

- debt instruments;
- equity investments, and
- derivatives.

Debt instruments

A debt instrument may still be measured at amortised cost as permitted by the current standard. However, the criteria for amortised cost measurement for financial assets and financial liabilities have changed. Only instruments that (1) have basic loan features and (2) are managed on a contractual yield basis may be measured at amortised cost (both criteria are described in more detail below). Therefore, amortised cost accounting cannot be used for derivative instruments and equity investments (as these are not lending or borrowing arrangements), many debt instruments that under the existing standard have complex embedded derivative features (as these may not be basic loan features) or debt instruments held for trading (as these could not be managed on a contractual yield basis). Debt instruments that do not meet the conditions for amortised cost accounting must be measured at fair value through profit or loss – no alternative exists.

As a consequence of restricting amortised cost accounting to those instruments that exhibit basic loan features there is no longer a requirement to assess hybrid *financial* instruments that are in the scope of the existing IAS 39 for embedded derivatives (the existing requirements for embedded derivatives in non-financial host contracts and financial host contracts outside the scope of IAS 39 will be retained). Instead if the instrument contains any non-basic loan features the whole instrument must be fair valued through profit or loss.

The criteria for amortised cost measurement do not make a distinction between debt instruments that are quoted in an active market and those that are not. Therefore, a debt instrument quoted in an active market could qualify for amortised cost accounting. Under current IAS 39, this is only permitted if the entity can assert that it has the intention and ability to hold the quoted debt instrument to its maturity. The assertion of the intent and ability to hold to maturity is not required under the proposals. Further, if the entity subsequently sold an asset that was measured at amortised cost, under the proposals, it would not be subject to any tainting provisions such as those that exist under the current held-to-maturity classification. Instead, if a debt instrument measured at amortised cost is derecognised, IAS 1 *Presentation of Financial Statements* is amended to require the gain/loss on disposal to be separately disclosed in the statement of comprehensive income, and IFRS 7 *Financial Instruments: Disclosures* is amended to require a reconciliation of that gain/loss.

An entity that meets both conditions for amortised cost accounting has the option to designate the instrument at FVTPL on initial recognition if it reduces an accounting measurement mismatch that would otherwise arise (see below for further detail).

This ED does not propose any changes to the mechanics of amortised cost accounting. Changes may be proposed in the ED on impairment (expected in the fourth quarter of 2009) which may propose a shift from an incurred loss model to an expected loss model.

Basic loan features

Generally, a debt instrument with basic loan features is one that repays principal with interest (contractual or imputed) where the interest is either a fixed rate or an unleveraged floating market rate of interest, or a combination of the two (for example floating rate with an embedded cap, floor or collar). Other common features in debt instruments such as prepayment options are considered basic loan features provided (i) they are not contingent on future events[1] and (ii) the prepayment amount substantially represent unpaid amounts of principal and interest. As a result, debt instruments with more complex embedded features, for example where the return is linked to equity or commodity price/indices, will not qualify for amortised cost accounting and would be required to be measured in their entirety at FVTPL.

The introduction of basic loan features as a criterion for amortised cost measurement for debt instruments has removed the need to identify and fair value embedded derivatives. It should be noted, however, that all embedded derivatives that are currently required to be separated for debt instruments not measured as at FVTPL because they were assessed as not being closely related to the debt host contract will not automatically fail the basic loan features definition. Conversely, debt instruments that under the current standard were not FVTPL and did not require the recognition of separate embedded derivatives will not automatically meet the basic loan features criteria. A thorough understanding of the terms of the debt instrument will be required in order to determine whether the debt instrument has basic loan features.

Concentration of credit risk

A debt instrument may appear at first glance to have basic loan features based on its contractual terms. However, under the proposal an entity is required to consider the effects of subordination on the cash flows of the instrument as certain types of subordination are not considered to be basic loan features.

The ranking of an entity's creditors that arises from commercial law will result in some instruments, for example trade creditors, providing credit protection to other instruments such as senior liabilities. This type of subordination is considered to be consistent with the notion of a basic loan feature as the credit risk exposure is not viewed as leveraged.

Conversely, a structured investment vehicle that issues different tranches of debt instruments that prioritises payments by specifying the order in which any losses of the issuer are allocated (commonly referred to as a waterfall structure) will result in some tranches providing credit protection to other tranches. Those tranches that provide credit protection to other tranches are considered leveraged and hence do not have basic loan features. In such structures only the most senior tranche does not provide credit protection (it only receives credit protection from other more junior tranches) and therefore it will be the only tranche that could have basic loan features and potentially be eligible for amortised cost measurement.

Common structured investment vehicles that issue tranches of debt instruments in this way (i.e. subject to a waterfall) are collateralised debt obligation (CDO) vehicles. Under current IAS 39, CDOs that are not classified at FVTPL are assessed for embedded derivatives. This assessment involves looking to the underlying instruments in the issuing vehicle to determine whether the CDO is a cash-CDO (where the issuing entity invests only in cash instruments, such as corporate bonds, to gain credit risk exposure) or is a synthetic-CDO (where the issuing entity invests in credit derivatives to gain credit risk exposure). Synthetic CDOs, whether issued or held that are not classified as at FVTPL, are determined to have embedded credit derivatives that are not closely related to the debt host contract requiring embedded derivative separation. In contrast cash-CDOs are considered to contain embedded credit derivatives that are closely related to the debt host contract resulting in the entire instrument being potentially eligible for amortised cost measurement.

As the proposals focus on the relative subordination of credit risk to other tranches when assessing whether the instrument must be measured in its entirety as at FVTPL they do not make the distinction between cash-CDOs or synthetic CDOs as in the current standard.

CDOs that are not held or issued for trading	Is FVTPL required?	
	IAS 39	**Proposals**
Cash-CDO		
Most senior	No	No
Not most senior	No	Yes, for entire instrument
Synthetic-CDOs		
Most senior	Yes, for embedded derivative	No
Not most senior	Yes, for embedded derivative	Yes, for entire instrument

Managed on a contractual yield basis

Debt instruments are considered to be managed on a contractual yield basis only if they are managed and their performance evaluated by key management personnel on the basis of their contractual cash flows. This condition is designed to distinguish between instruments that will be realised (or extinguished) by collecting (or paying) the contractual cash flows on the instrument and those instruments that will be transferred before maturity to realise fair value changes. As a result trade accounts receivable (or payable) that are not intended to be sold are managed on a contractual yield basis whereas instruments held for trading are not.

The assessment of this condition does not take into account management's intentions for an individual instrument but instead considers the entity's business model that applies to instruments collectively. The proposal recognises that an entity may have more than one business unit with different business models which could result in similar instruments being managed in different ways and hence being classified differently. For example, a financial institution may have a business unit where originated loans are intended to be securitised leading to derecognition of the loans. At initial recognition management's intention for that business unit is to maximise proceeds from securitisation, not through receipt of the cash flows under the loans. However, a different business unit that originates loans without the intention to securitise may have a different policy and could potentially qualify for amortised cost measurement.

The proposals make clear that the acquisition of a debt instrument at a discount to par due to incurred credit losses inherent in the asset cannot be regarded as managed on a contractual yield basis. The proposals consider that an investor acquires such an instrument on the expectation that the actual losses will be less than the losses that are reflected in the purchase price. As the instrument creates an exposure to significant variability in actual cash flows and such variability is not interest the asset cannot be measured at amortised cost whereas under the current standard it could.

Fair value option

The revised standard will include an option to designate at fair value a debt instrument that otherwise meets the conditions for amortised cost accounting. This option is only permitted when designating at FVTPL eliminates or significantly reduces an accounting measurement mismatch that would otherwise arise. This condition is the same as one of the three cases where the fair value option can be used in the existing standard. The other two cases where the fair value option is permitted in the existing standard are when the instrument contains an embedded derivative that is not closely related and significantly modifies the cash flows required by the contract, or when the instrument is part of a group of financial assets and/or financial liabilities that is managed and its performance evaluated on a fair value basis. Under the proposals most instruments satisfying either of these two conditions will be accounted for at FVTPL, hence rendering the option redundant in those instances.

Equity investments

The proposed new standard will require *all* equity investments to be recorded in the statement of financial position at fair value. This represents a change only for unquoted equity instruments whose fair value cannot be reliably measured where the current standard requires measurement at cost less impairment.

There are two possibilities for the presentation of fair value gains and losses and dividend income arising from equity investments held. The default treatment is to present these in profit or loss in the FVTPL category. However, for equity instruments that are not held for trading there is the option, at initial recognition, to elect to record *all* fair value gains and losses and dividend income in other comprehensive income – permanently. This new category is called fair value through other comprehensive income. There is no reclassification of gains or losses to profit or loss on disposal, impairment or receipt of dividend. This option can be used on an instrument by instrument basis in a similar way to the option to designate at FVTPL at initial recognition under the current standard.

Note that this standard does not propose any changes in the measurement and accounting of equity instruments issued as IAS 32 *Financial Instruments: Presentation* is unchanged.

Derivatives

The proposed standard does not significantly impact the accounting of derivatives, however there are two changes in this area. Firstly, the exposure draft proposes to remove the requirement to separately account for embedded derivatives in hybrid financial instruments within the scope of IAS 39 that are not measured at FVTPL. Secondly, it requires all derivatives linked to and settled by the delivery of unquoted equity instruments to be measured at fair value (whereas the current standard requires the use of cost less impairment if fair value cannot be reliably measured).

Impact analysis

The impact of the proposals compared to the current standard will vary considerably amongst entities. The extent of change will depend on the financial instruments recognised in the statement of financial position, the measurement elections the entity made under the current standard and what elections will be made under the proposals.

The statements of financial position presented below provide an illustration of how the classification and measurement of financial instruments held by an example corporate entity, an example banking entity and an example insurance entity could change as a result of adopting the new proposed standard. Where the measurement basis and/or income recognition has changed for any line item this is highlighted. For illustrative purposes only, non-financial assets and liabilities are not included as they are unaffected by the proposals. See references for further detail justifying the new classifications.

Statement of financial position – Corporate

	Current IAS 39 Classification[2]	Proposed new IAS 39 classification	Reference
Assets			
Cash and cash equivalents	L&R	AC	(A)
Investments			
• listed debt securities	HTM	AC	(A)
• quoted equity securities	AFS	FVTPL	(C)
• unquoted equity securities	Cost[3]	FVTOCI	(D)
Derivatives			
• held for cash flow hedging	HfH	HfH	(H)
• embedded derivatives	HFT	n/a	(F)
Trade and other receivables	L&R	AC	(A)
Liabilities			
Short term borrowings	AC	AC	(A)
Trade and other payables	AC	AC	(A)
Long term borrowings	AC	AC	(A)
Derivatives held for hedging	HFT[4]	FVTPL	(H)
Host debt contracts	AC	n/a	(F)

Statement of financial position – Bank

	Current IAS 39 Classification[2]	Proposed new IAS 39 classification	Reference
Assets			
Cash and balances with central banks	L&R	AC	(A)
Debt securities:			
– listed debt securities	FVO[5]	FVTPL	(B)
– listed debt securities	AFS	AC	(A)
– listed debt securities	HTM	AC	(A)
Loans and advances	L&R	AC	(A)
Debt securities held for trading	HFT	FVTPL	(B)
Other debt securities:			
– super senior asset backed securities (quoted in an active market)[6]	AFS	AC	(A)
– subordinated debt securities (not quoted in an active market)[6]	L&R	FVTPL	(B)
Equity shares held for trading	HFT	FVTPL	(B)
Other equity shares:			
– quoted equities	AFS	FVTPL	(C)
– unquoted equities	Cost[3]	FVTOCI	(D)
Investment in subsidiary (in separate financial statements)	AFS[7]	FVTOCI	(E)
Investment in associate	FVO[8]	FVTPL	(C)
Derivatives:			
– held for trading	HFT	FVTPL	(B)
– held for net investment hedging	HfH	HfH	(H)
Liabilities			
Deposits by banks	AC	AC	(A)
Customer accounts	AC	AC	(A)
Debt securities in issue:			
– floating rate	AC	AC	(A)
– fixed rate	FVO[9]	FVTPL-FVO	(G)
– leveraged rate products	FVO[10]	FVTPL	(B)
– debt host contracts	AC	n/a	(F)
Short positions	FVTPL	FVTPL	(B)
Derivatives:			
– held for trading	HFT	FVTPL	(B)
– held for cash flow hedging	HfH	HfH	(H)
– embedded derivatives	HFT	n/a	(F)

Abbreviation	Classification description
L&R	Loan and receivable
AFS	Available for sale
HFT	Held for trading
FVO	Fair value option
Cost	Cost
HfH	Held for hedging
AC	Amortised cost
FVTPL	Fair value through profit or loss
FVTOCI	Fair value through other comprehensive income
Highlighted lines indicate changes in classification	

Statement of financial position – Insurer

	Current IAS 39 Classification[2]	Proposed new IAS 39 classification	Reference
Assets			
Cash and balances with banks	L&R	AC	(A)
Debt securities			
– listed debt securities	FVO[5]	FVTPL	(B)
– listed debt securities	AFS	AC	(A)
– listed debt securities	AFS	FVTPL	(B)
– listed debt securities	HFT	FVTPL	(B)
– listed debt securities	HTM	AC	(A)
– listed debt securities	HTM	FVTPL	(B)
Equity shares			
– quoted equities	HFT	FVTPL	(C)
– quoted equities	FVO	FVTPL	(C)
– quoted equities	AFS	FVTPL	(C)
– quoted equities	AFS	FVTOCI	(D)
– unquoted equities	Cost[3]	FVTOCI	(D)
Investment in subsidiary (in separate financial statements)	AFS[7]	FVTOCI	(E)
Derivatives:			
– held for trading	HFT	FVTPL	(B)
– held for net investment hedging	HfH	HfH	(H)
– embedded derivatives	HFT	n/a	(F)
Liabilities			
Investment contracts (no DPF)	AC	AC	(A)
Investment contracts(no DPF)	FVO	FVTPL	(B)
Investment contracts (with DPF)	IFRS 4	IFRS 4	(I) (J)
Insurance contracts (with DPF)	IFRS 4	IFRS 4	(I) (J)
Insurance contracts (no DPF)	IFRS 4	IFRS 4	(I) (J)
Debt securities in issue:			
– floating rate	AC	AC	(A)
– fixed rate	FVO[9]	FVTPL-FVO	(G)
– leveraged rate products	FVO[10]	FVTPL	(B)
– debt host contracts	AC	n/a	(F)
Derivatives:			
– held for trading	HFT	FVTPL	(B)
– held for cash flow hedging	HfH	HfH	(H)
– embedded derivatives	HFT	n/a	(F)

References

A. This line item consists solely of cash or instruments that have basic loan features and are managed on a contractual yield basis. As the fair value option has not been invoked for these instruments, they must be accounted for at amortised cost.

B. This line item consists solely of instruments that either do not exhibit basic loan features or are not managed on a contractual yield basis. The failure to meet both of these conditions results in the mandatory classification of these instruments at FVTPL. This treatment is not affected by whether the instrument is quoted or not quoted in an active market. No alternative treatment exists for these instruments.

C. This line item consists solely of equity instruments in scope of the standard which must be recorded in the statement of financial position at fair value. There is no exception to this requirement. The entity has not elected to recognise all fair value gains and losses and dividend income permanently in other comprehensive income and therefore must recognise all gains and losses in profit or loss.

D. This line item consists solely of equity instruments in scope of the standard which are required to be recorded in the statement of financial position at fair value. There is no exception to this requirement. The entity has elected to recognise all fair value gains and losses and dividend income permanently in other comprehensive income. Had the entity not made this election, fair value gains and losses would be recognised in profit or loss.

E. In its separate financial statements the entity has elected to apply the proposed new standard to account for its investment in subsidiary instead of IAS 27. See (D) for the accounting treatment applied.

F. This line item consists of embedded derivatives or hosts contracts that were required to be accounted for separately under the current standard. Under the proposals embedded derivatives are not separated from hybrid financial instruments inside the scope of IAS 39. Instead, the entire hybrid financial contract is classified based on the terms of the entire arrangement as either amortised cost or FVTPL. Therefore, all embedded derivatives and host contracts are included in other lines in the statement of financial position.

G. The fair value option has been elected for all debt instruments in this line item to reduce a measurement mismatch that would otherwise arise if the default treatment of amortised cost was applied.

H. Changes in the classification of hedged items may impact existing hedge relationships. The accounting treatment of hedging derivatives designated in qualifying hedge relationships is not impacted by this ED. A separate ED on hedge accounting is due to be issued later in 2009.

I. Insurance contracts with and without Discretionary Participation Features (DPF) and investment contracts with DPF are within the scope of IFRS 4 rather than IAS 39

J. These line items consist of financial instruments and insurance contracts with DPF. They are liabilities with a guaranteed element (often a guaranteed interest rate) and a significant additional benefit that insurers determine on a discretionary basis usually within the return of a specified pool of assets. Under current IAS 39 the entity classifies the assets in these pools as AFS debt and equity securities. The entity has elected to use the "shadow accounting" policy option under IFRS 4 which permits the recognition of changes in the DPF liability directly in equity if unrealised gains or losses on the specified assets are also recognised in equity. Under the shadow accounting policy the accounting for the DPF liabilities will change following the application of references (A), (C) and (E) to the assets in the specified pools.

Notes

1 For this purpose, terms that protect the lender from credit deterioration of the borrower in cases of default, credit downgrades and loan covenant violations, and terms relating to possible future changes in taxation, law and similar factors that protect the lender are not considered to be contingent on future events.

2 In some cases alternative classifications may be permitted.

3 The entity measures these unquoted equity investments at cost (in accordance with IAS 39.46(c)) as fair value cannot be reliably measured.

4 The entity holds these derivatives for hedging purposes but has not designated them in hedge accounting relationships and therefore they are classified as held for trading.

5 The entity has invoked the fair value option for all instruments in this line item because they are all managed and their performance is evaluated on a fair value basis.

6 The entity does not hold these securities for trading purposes and does not intend to hold them to maturity. The securities are part of multiple securities issued from collateralised debt obligation vehicles where payments are prioritised based on a predetermined order. The super senior securities in the structure have priority of payment such that they suffer losses last, whilst the junior securities in the structure are the first to suffer losses.

7 In its separate financial statements the entity has elected to classify its subsidiary as an available-for-sale asset in accordance with IAS 39. Investments in subsidiaries accounted for at cost in the separate financial statements in accordance with IAS 27 Consolidated and Separate Financial Statements are not impacted by this ED.

8 This investment in associate is held by the venture capital business unit of the entity. In the group accounts the entity has elected to account for the investment in accordance with IAS 39 by designating it at FVTPL on initial recognition (which is the same as the treatment adopted in the separate financial statements).

9 The entity has invoked the fair value option for all instruments in this line item in order to reduce an accounting measurement mismatch that would otherwise arise (with receive-fixed interest rate swaps that are measured at FVTPL).

10 The entity has invoked the fair value option for all instruments in this line item because each instrument contains an embedded derivative that must otherwise be accounted for separately at FVTPL.

Disclosures

The ED proposes consequential amendments to IFRS 7 *Financial Instruments: Disclosures* and IAS 1 *Presentation of Financial Statements.* Many of the amendments to IFRS 7 merely update the standard for changes in terminology as a result of the reduced number of financial instrument categories. However, there are some new disclosure requirements.

Where equity investments are designated as at FVTOCI the entity is required to disclose:

- which investments have been designated;
- the reasons for designating;
- the fair value of each investment at the end of the reporting period;
- any transfers of the cumulative gain or loss within equity during the period other than on disposal, including the reasons for such transfers, and
- in the case of sales of designated equity investments the reasons for disposing of the investments and the cumulative gain or loss transferred within equity on disposal

Under the proposed changes to IFRS 7 an entity would also be required to disclose a reconciliation of the gain or loss recognised in the statement of comprehensive income arising from the derecognition of financial assets and financial liabilities measured at amortised cost. Proposed changes to IAS 1 would require disclosure of the gains and losses on disposal of amortised cost financial instruments on the face of the statement of comprehensive income.

If an entity were to early adopt the standard the following additional items would need to be disclosed in relation to each class of financial assets and financial liabilities at the date of initial application (in tabular format unless another format is more appropriate):

- the original measurement category and carrying amount determined in accordance with IAS 39;
- the new measurement category and carrying amount determined in accordance with the new requirements;
- the amount of any financial assets or financial liabilities designated at FVTPL under the new requirements (and their original measurement basis and presentation method); and
- the amount any financial assets or financial liabilities previously designated at FVTPL that are not designated in this way under the new requirements, distinguishing between those the entity is required to reclassify and those it has elected to reclassify.

In addition, the entity is required to disclose qualitative information to enable users to better understand:

- the reasons for how it applied the new classification requirements for those financial assets and financial liabilities were classification has changed; and
- the reasons for any designation or revocation of designation at fair value through profit and loss.

Effective date and transitional provisions

The effective date of the proposals (if finalised) has not yet been determined. The Board will review the effective date of the proposals but expects the new requirements will not be mandatory for periods beginning before January 2012. Earlier application will be permitted with the requirement in such cases to disclose this fact. The Board plans to develop an IFRS from the proposals in this ED to be available for early adoption in time for 2009 year-end financial statements.

The proposals would require retrospective application in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* subject to certain transitional provisions. The following would have retrospective effect under the proposals:

- assessment of whether an instrument meets the conditions for amortised cost accounting at the date of initial application (the date when the entity first applies the new requirements);
- designation of a financial asset or financial liability at FVTPL (or the revoking of such previous designation) on the basis of facts and circumstances that existed at the date of initial application; and
- designation of an investment in an equity instrument as at FVTOCI on the basis of facts and circumstances that existed at the date of initial application.

Any hedge relationship that is de-designated as a consequence of the new requirements would be accounted for as a discontinuation of hedge accounting from the date of initial application applying the existing guidance on that topic in IAS 39.91 & 101.

The proposals contain some specific detailed requirements that provide relief from full retrospective in cases where:

- the fair value of financial instruments had not been determined in comparative periods;
- investments in unquoted equity investments and derivatives settled by delivering of such investments are measured at cost;
- the determination of amortised cost or impairment retrospectively is impracticable (in accordance with IAS 8); or
- the application of the requirements to prior interim periods is impracticable (in accordance with IAS 8) for an entity reporting in accordance with IAS 34 *Interim Financial Reporting.*

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