Australian Government
Australian Accounting Standards Board

Memorandum

To:	**AASB Members**	**Date:**	26 November 2013
From:	**Sue Lightfoot**	**Agenda Item:**	9.1
Subject:	**Financial Instruments: Project update**	**File:**	

Action

- Receive an update on the IASB's project to replace IAS 39 *Financial Instruments: Recognition and Measurement* with IFRS 9 *Financial Instruments*, in particular, the progress of the classification and measurement, and impairment phases; and consider whether there are any issues that need to be raised with the IASB on tentative decisions made by the IASB.
- Consider the issuance of the IASB's amending standard IFRS 9 *Financial Instruments (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39)* with a view to providing direction to staff issuance of an amending standard to AASB 9.
- Consider the following with a view to providing staff with directions for amending Tier 2 reduced disclosure requirements for disclosures arising from IFRS 9 (2013):
    - submissions on ED 208 *Tier 2 Supplement to AASB Exposure Draft ED/2010/13 Hedge Accounting*.
    - implications for Tier 2 disclosures arising from differences between disclosures in ED 208 and the amendments to IFRS 9

Attachments

Agenda paper 9.2 – IFRS Standard IFRS 9 *Financial Instruments (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39)*

Agenda paper 9.3 – Tier 2 Disclosures Arising from IFRS 9 (2013)

Agenda paper 9.4 – Comment letters received on Tier 2 Supplement to ED208 *Hedge Accounting*

IFRS 9 *Financial Instruments (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39)*

Background

In November 2013 the IASB issued International Financial Reporting Standard IFRS 9 *Financial Instruments Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39*. For the purpose of this memorandum, the amending standard is referred to as 'IFRS 9 (2013)'.

The IASB has published on its website a high level overview of the amendments which can be located here.

The amending standard amends IFRS 9, IFRS 7 and IAS 39 and consequentially amends a number of other Standards and Interpretations. The key amendments are to add Chapter 6 on Hedge Accounting; to permit the 'own credit risk' provisions to be early applied in isolation, and to remove the effective date of IFRS 9.

To recap, the IASB is replacing IAS 39 in a phased approach. The main phases are:

- Phase 1: Classification and measurement of financial assets and financial liabilities
- Phase 2: Impairment
- Phase 3: Hedge Accounting

To date the IASB has issued IFRS 9 (2009) addressing classification and measurement of financial assets and IFRS 9 (2010) addressing classification of both financial assets and financial liabilities. Limited amendments to classification and measurement were proposed in the IASB's ED/2012/4 and proposals on impairment have been included in three exposure drafts to date. As at the date of this memorandum, the IASB's workplan indicates that the IASB intends to issue a complete IFRS 9 by end of Q2 2014.

Macro hedge accounting has been scoped out of the IFRS 9 project. The IASB workplan as at the date of this memo indicates that the IASB will issue a Discussion Paper on macro hedge accounting in the Q1 2014.

The three main changes introduced by IFRS 9 (2013) are 1) a new chapter on hedge accounting, 2) changes to the 'own credit risk' provisions, and 3) removing the mandatory effective date of IFRS 9. These three main changes are considered below:

1 Hedge Accounting

In December 2010, the AASB issued ED 208 *Hedge Accounting* which incorporated IASB ED/2010/13 (of the same title). The comment periods for ED 208 and ED/2010/13 closed on 18 February 2011 and 9 March 2011 respectively. The AASB received six comment letters in response to ED208 and submitted a comment letter to the IASB dated 9 March 2011.

In September 2012 the IASB made available on its website a Draft Standard on Hedge Accounting. The AASB also made the draft available on its website and received three comment letters in response to the Draft Standard. These were provided to the Board as Agenda Paper 11.2 of the December 2012 meeting and Agenda Paper 8.3 of the February 2013 meeting.

The AASB submitted a comment letter to the IASB dated 21 December 2012 in respect of the Draft Standard. In that letter the AASB identified that, whilst overall the draft requirements were welcomed by constituents, some had concerns about the draft requirements in paragraph B6.5.5 to require that foreign currency basis risk is excluded from the measurement of the hedged item for the purpose of measuring hedge effectiveness of a hedging relationship that includes a cross-currency interest rate swap. The AASB encouraged the IASB to further consider the draft requirements in this paragraph before the finalising the chapter of IFRS 9 on hedge accounting.

In its January 2013 meeting the IASB discussed the feedback it had received on the Draft Standard. In particular the following three issues were discussed:

(a) cross-currency basis risk and the use of the hypothetical derivative to measure hedge effectiveness (the issue raised by the letter from the AASB in December 2012);

(b) the transition requirements for designation of ‘own-use’ contracts as ‘at fair value through profit or loss’; and

(c) the interaction of the review draft and existing requirements in IAS 39 for applying hedge accounting for macro (portfolio) hedges

These issues were set out in Agenda Paper 8.1 of the February 2013 AASB meeting. At that meeting the AASB decided there were no issues that ought to be raised with the IASB at that stage. On review of the final amending standard, the requirements appear consistent with the previous decisions of the IASB which the AASB considered in its February meeting and which address the issue on cross-currency swaps raised in the AASB’s letter in December 2012.

2 ‘Own credit risk’ provisions – early application

IFRS 9 (2010) introduced requirements relating to presentation of gains and losses of financial liabilities designated as at fair value through profit or loss, with changes in fair value due to changes in own credit risk being recognised through other comprehensive income (OCI). For the purpose of this memorandum those requirements are referred to as the ‘own credit risk’ provisions. Prior to the issuance of IFRS 9 (2013), in order to apply the ‘own credit’ provisions an entity would be required to apply all the requirements of IFRS 9 (2010).

IFRS 9 (2013) paragraph 7.1.2 amends IFRS 9 to permit an entity to elect to apply the ‘own credit risk’ provisions without applying the other requirements in IFRS 9. If an entity does so, it is required to disclose that fact and provide the disclosures in paragraphs 10-11 of IFRS 7 concerning financial liabilities designated at fair value. These disclosure paragraphs were added to IFRS 9 in 2010 and were not amended in IFRS 9 (2013).

In November 2012 the AASB issued ED230 *Classification and Measurement: Limited Amendments to IFRS 9* (which incorporated the IASB ED/2012/3 of the same name) and asked the following question:

> **Question 8:** Do you agree that entities should be permitted to choose to early apply only the ‘own credit’ provisions in IFRS 9 once the completed version of IFRS 9 is issued? If not, why and what do you propose instead?

The AASB received eight comment letters in response to ED 230. A comment letter analysis and issues paper was provided as Agenda Paper 8.4 at the February 2013 AASB meeting. The AASB submitted a comment letter to the dated 5 April 2013 in response to the IASB’s ED/2012/4. That letter can be located here:

In its submission the AASB agreed that entities should be permitted to choose to early apply only the ‘own credit risk’ provisions in IFRS 9 once the completed version of IFRS 9 is issued.

Although IFRS 9 has not yet been completed, staff recommend that the AASB support the amendment to permit entities to early adopt the ‘own credit risk’ provisions in isolation, consistent with its comment to the IASB in response to ED/2012/4.

3 Mandatory Effective Date

In its amending standard the IASB has withdrawn the mandatory effective date of IFRS 9, whilst allowing early application. However, at its November 2013 meeting IASB tentatively decided that the mandatory effective date of IFRS 9 will be no earlier than annual periods beginning on or after 1 January 2017.

Staff recommend that the AASB issues an amending standard to AASB 9 consistent with IFRS 9 (2013), permitting early application of the requirements but including a mandatory effective date.

The rationale for this recommendation is explained below:

When early application is permitted by an IFRS, the AASB's past practice has been to also permit early application in the equivalent Australian accounting standard where no additional AASB guidance is to be issued. (No additional AASB guidance was issued in relation to AASB 139 on hedge accounting and staff propose that no additional guidance is necessary in relation to IFRS 9 hedge accounting requirements).

The Corporations Act 2001 section 334 paragraph 4 states the following:

(4) An accounting standard applies to:

(a) periods ending after the commencement date of the standard; or

(b) periods ending, or starting, on or after a later date specified in the standard.

Based on the above, in the absence of the standard including a specified mandatory effective date, the staff understand that the requirements would become immediately mandatory for periods ending after the issuance of the standard.

Staff propose that the AASB 9 amending standard should be mandatorily applicable to annual reporting periods beginning on or after 1 January 2017, with early application permitted consistent with the IFRS 9 amending standard. This would allow 3 years post the expected date of completion IFRS 9 of 2014. Staff also propose that constituents are advised that the date is subject to revision but needed for legislative purposes.

Questions to the Board members

1 Does the Board agree that the staff should proceed to prepare a ballot draft of an IFRS 9 amending standard to incorporate the amendments in IFRS 9 *Hedge Accounting*?

2 Does the Board agree that the amending standard should be mandatorily applicable to annual reporting periods beginning on or after 1 January 2017, with early application permitted consistent with the IFRS 9 amending standard?

<u>Tier 2 Proposals</u>

The AASB issued a Tier 2 Supplement to ED 208 *Hedge Accounting* in March 2011. The comment period closed on 2 June 2011. Two comment letters were received by the AASB, from PricewaterhouseCoopers dated 16 March 2011 and KPMG dated 3 June 2011. Their comments and staff responses and recommendations are included in the attached agenda paper 9.3, including comparison of the disclosures in ED208 to those in IFRS 9 *Hedge Accounting*.

Staff consider that the proposed approach to the new and significantly changed disclosures is consistent with the approach for the disclosures that were exposed in ED208, which were largely supported by constituents, therefore staff do not see any need to re-expose the final Tier 2 disclosure requirements.

Question to Board members:

Does the Board agree with staff's recommendations to:

(a) amend the Tier 2 disclosure requirements as recommended by staff based on the analysis of submissions received on ED 208?

(b) amend Tier 2 disclosure requirements as recommended by staff based on the analysis of additional disclosure requirements included in revised IFRS 9 *Hedge Accounting*?

Classification and Measurement and Impairment

In its October and November meetings the IASB continued to redeliberate on ED/2012/4 *Classification and Measurement: Limited Amendments to IFRS 9* and ED/2013/3 *Financial Instruments: Expected Credit Losses*.

The most recent IASB work plan identifies that the IASB is targeting issuance of those phases of IFRS 9 as a standard in H1 2014.

Staff will provide a detailed update on the tentative decisions of the IASB on those phases of the IFRS 9 project at the December AASB meeting.