The long trek to IFRS 9, part two

IN THE CONCLUDING PART OF HIS EXAMINATION OF THE EVOLVING REQUIREMENTS OF FINANCIAL INSTRUMENT ACCOUNTING, **MATEUSZ LASIK** CONSIDERS IMPAIRMENT AND HEDGE ACCOUNTING, BUT STARTS BY EXPLAINING THE TRANSITION ARRANGEMENTS.

The effective date of IFRS 9 is for annual periods beginning on or after 1 January 2013, with early adoption permitted. The standard must be applied retrospectively. However, the business model assessment is to be made at the date of initial application (when an entity first applies IFRS 9). Also there is specific guidance on designation at fair value through profit and loss (FVTPL) and fair value through other comprehensive income (FVTOCI) on transition.

Entities adopting the new standard with an initial application date before 1 January 2012 will not have to restate prior periods. To give first-time adopters the same allowance, a similar exemption is included as a consequential amendment in IFRS 1: First-time Adoption of IFRS. Corporate treasurers within European entities will wish to monitor closely developments at the European level as IFRS 9 has yet to be endorsed for use within the EU. At the time of writing it is not yet available for early application.

CLASSIFICATION AND MEASUREMENT: FINANCIAL LIABILITIES The requirements of IFRS 9 will result in a number of changes relative to current accounting under IAS 39 in terms of classification and measurement (see Table on page 18). In response to concerns, the IASB published an exposure draft, Fair Value Option for Financial Liabilities, in May 2010. This proposed that in the case of financial liabilities designated as at fair value through profit and loss (FVTPL) the change in fair value should be shown in profit or loss but the portion of the fair value movement due to own credit would be shown in other comprehensive income (equity). The only other change compared with IAS 39 is that the IASB proposes that all derivative liabilities must be measured at fair value, removing the exemption in IAS 39 to measure certain derivatives over unquoted equity instruments. The comment period for the draft has now closed.

IMPAIRMENT The exposure draft Amortised Cost and Impairment was published in November 2009 with a comment deadline of 30 June 2010. It proposes an expected loss model of impairment. The present incurred loss model under IAS 39 requires that interest income initially be recognised on the basis of full contractual cashflows without making any allowances for expected credit losses. Impairment is then recognised only when there is a trigger event indicating that a loss has been incurred, which can lead to effective deferral of losses. The exposure draft would require an entity to:

- determine the expected credit losses on a financial asset when that asset is first recognised;
- recognise contractual interest revenue, less the initial expected credit losses, over the life of the instrument;
- build up a provision over the life of the instrument for the expected credit losses;

- reassess the expected credit loss each period; and
- recognise immediately the effects of any changes in credit loss expectations.

The proposed model will affect corporates in terms of impairment of trade receivables as well as interest recognition and impairment of instruments such as bonds held as investments. The proposals also include allowances for practical expedients where the overall effect is immaterial (e.g. use of a provision matrix in the case of short-term trade receivables).

HEDGE ACCOUNTING: THE GREAT HOPE FOR TREASURERS?
Probably the area of most interest to corporate treasurers in the IAS 39 replacement project will be the proposals on hedge accounting. The IASB is set to issue an exposure draft on hedge accounting this month. The board aims to improve the decision-usefulness of financial statements by fundamentally reconsidering current hedge accounting requirements, looking at both financial and non-financial hedged items. This is against the backdrop of the proposals issued by the US Financial Accounting Standards Board (FASB) in May 2010 to change the hedge accounting guidance in US GAAP so that:

- the threshold for hedge accounting would become "reasonably effective" instead of "highly effective";
- a quantitative assessment of effectiveness would be required only if a qualitative assessment could not establish that hedge accounting would be reasonably effective; after assessment an entity would not need to perform a hedge effectiveness assessment unless changes in circumstances indicate the relationship might no longer be reasonably effective; and
- the ability for an entity to elect to dedesignate a hedging relationship would be removed.

The IASB has been developing its proposals and has considered topics such as the eligibility of groups of hedged items for designation in hedging relationships (including net positions), using cashflow hedge accounting for fair value hedges, loosening the effectiveness testing, allowing portions of non-financial items to be hedged (where contractually specified), and allowing derivatives to be hedged items.

Given their close involvement in the practicalities of hedge accounting, corporate treasurers will likely follow the progress of this phase of the projects with much interest and high hopes.

DERECOGNITION: REFORM POSTPONED In April 2009 the IASB published its derecognition exposure draft, with proposals for changing the current derecognition requirements in IAS 39 for financial assets and financial liabilities. It represented a shift towards a control-based model of derecognition and away from risk and reward, and would have affected corporates using debt factoring and securitisation mechanisms to manage their trade receivables.

In the second quarter of 2010 it became clear that the IASB and FASB had divergent views on the way forward. As a result, it was agreed that for derecognition the IASB would publish only new disclosure requirements in the third quarter of 2010. Any further consideration of changing the derecognition model is postponed until 2012 when the FASB will conclude its post-implementation review of the application of its amended derecognition requirements. In short, the derecognition requirements of IAS 39 will be with us for some time.

UNANSWERED QUESTIONS A number of questions remain as to the future shape of IFRS 9 in addition to the uncertain direction of proposals over hedge accounting and the final shape of the impairment requirements. The FASB published its proposed financial instruments accounting model in May 2010. In a number of areas (impairment, classification and measurement) the proposals differ from the IASB's model.

One of the interesting questions is whether and to what extent the two boards will be able to converge their requirements. Under the update to their convergence plan there is a goal for the IASB and FASB to complete their joint consideration of feedback received (on both boards' proposals) and issue new standards on financial instruments by the second quarter of 2011.

Uncertainty also surrounds eventual EU endorsement of IFRS 9 once it is completed in its final form. The effective date of any revised financial instruments standard is yet to be determined, although it is likely to be either 2013 or 2014.

Given all of the above, corporate treasurers will want to follow the development of IFRS 9 closely in the months and years to come.

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Table: IAS 39 v IFRS 9

Instrument	IAS 39 classifications	Impairment testing required?	New classifications under IFRS 9	Impairment testing required?
EQUITY INVESTMENTS	■ available-for-sale ■ cost less impairment ■ fair value through profit or loss	yes yes no	■ fair value through profit or loss ■ fair value through other comprehensive income	no no
DEBT INSTRUMENTS – ASSETS	■ available-for-sale ■ loan and receivable ■ held to maturity ■ fair value through profit or loss	yes yes yes no	■ fair value through profit or loss ■ amortised cost	no yes