



EAGLE WHITE PAPER

International Financial Reporting Standards – Are You Getting Ready for IFRS 9?

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EXECUTIVE SUMMARY

International Accounting Standard (IAS) 39 includes the IFRS requirements for recognizing and measuring financial assets and financial liabilities. The International Accounting Standards Committee (IASC), the predecessor to the International Accounting Standards Board (IASB), issued IAS 39 in December of 1999 and the standard became effective in January of 2001. The International Accounting Standards Board (IASB) became the successor to the IASC in April 2001. Interested parties often told the IASB that IAS 39 is too complex and difficult to understand, and recommended that a new standard be developed to account for financial instruments. In addition, due to the turmoil in the global financial markets and the diverse accounting practices being followed by companies worldwide, there was clearly a need to establish new requirements for accounting for financial assets and financial liabilities that will lead to more standardized accounting practices. In November 2008, the IASB added a project to its agenda to replace IAS 39 by changing the requirements for reporting financial instruments. The new requirements for accounting and reporting of financial instruments will be included in a new standard, IFRS 9. This standard is being developed across three phases and will replace relevant sections within IAS 39 as each phase is completed and incorporated within IFRS 9.

The three phases of IFRS 9 include: Phase 1 - Classification and Measurement of Financial Assets and Financial Liabilities, Phase 2 - Financial Instruments: Amortized Cost and Impairment, and Phase 3 - Hedge Accounting. The changes to accounting standards for financial instruments in IFRS 9 will have significant system and operations implications for organizations. The objective of this paper is to provide an overview of recent changes under Phase 1 of IFRS 9 (and additional changes that are being proposed and evaluated for Phases 2 and 3), so that companies can gain a better understanding of the new and potential requirements and how their operations may be impacted.

IFRS 9 PHASE 1: CLASSIFICATION AND MEASUREMENT OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

In July of 2009, the IASB published an exposure draft for Phase 1 and in November, 2009 issued IFRS 9 covering the classification and measurement of financial assets. Eleven months later, the IASB completed Phase 1 by adding to IFRS 9 the requirements for classification and measurement of financial liabilities. Entities are required to apply IFRS 9 for Phase 1 for annual periods beginning on or after January 1, 2013. Earlier application of IFRS 9 is permitted but will also require disclosure and application of various amendments to other international financial reporting standards.

CLASSIFICATION AND MEASUREMENT OF FINANCIAL ASSETS IN IFRS 9 FOR PHASE 1

- Entities shall classify financial assets with the regulatory categories of Amortized Cost, Fair Value, Fair Value Option or Fair Value-OCI (Other Comprehensive Income). Previously recognized regulatory categories under IAS 39, Available-for-Sale, Held-to-Maturity and Loans and Receivables are no longer applicable.
- Entities are required to classify financial assets based on the business model for managing the financial asset and the contractual cash flow characteristics of the financial asset
 - Entities should classify and measure financial assets at Amortized Cost if both of the following conditions are met:
 - Objective of business model is to hold assets to collect contractual cash flows
 - Contractual terms of the financial asset have specified dates for cash flows for payments of only principal and interest on the principal amount outstanding
 - Entities can classify financial assets at Fair Value and recognize changes in fair value through profit or loss unless it meets the above-mentioned requirements for measurement at amortized cost. The Fair Value regulatory category will also include financial assets that are held for trading.
 - Entities can make an irrevocable election to classify financial assets upon initial recognition with the regulatory category of Fair Value Option (as under IAS 39) and measure these assets at fair value through profit or loss to avoid an accounting mismatch.
 - Entities at initial recognition can make an irrevocable election to classify equity investments not held for trading with the regulatory category of Fair Value-OCI and report subsequent changes in fair value for these investments in other comprehensive income.
 - Under this election, entities are prohibited from recognizing gains and losses in profit or loss when the equity investment is derecognized, but can continue to report dividends from the equity investment in profit or loss.
- Unquoted Equity Instruments: Entities are now required to carry unquoted equity investments at fair value.
 - Exception: Entities are allowed to carry unquoted equity instruments at cost if there is a lack of recent information to measure fair value or cost represents the best estimate between a range of fair values.
- Hybrid Contracts: Entities are required to apply a regulatory classification to the entire hybrid contract if the host within the contract is a financial asset under IFRS 9. If the host within the hybrid contract is not a financial asset under IFRS 9, the embedded derivative may qualify to be accounted for separately from the host contract.
- Reclassification between regulatory categories can only occur when an entity changes its business model for

managing financial assets.

- Fair value is required to be determined at the reclassification date and becomes the new carrying amount for financial assets reclassified.

CLASSIFICATION AND MEASUREMENT OF FINANCIAL LIABILITIES IN IFRS 9 FOR PHASE 1

- Entities shall classify financial liabilities with the regulatory categories of Amortized Cost, Fair Value Option or Fair Value.
- Entities are required to classify and measure all financial liabilities, with a few exceptions, at Amortized Cost.
- Entities at initial recognition can make an irrevocable election to classify financial liabilities with the regulatory category of Fair Value Option.
 - Change in the fair value related to changes in the credit risk of the financial liability (excluding loan commitments and financial guarantee contracts) are reported in other comprehensive income unless the change results in an accounting mismatch in profit or loss. The assessment of the accounting mismatch related to credit risk is required to be made upon initial recognition of the financial liability and is an irrevocable.
 - The remaining change in fair value of the financial liability is recorded in profit or loss.
- Entities can classify financial liabilities with the regulatory category of Fair Value and carry these liabilities at fair value with fair value changes recognized through profit or loss (ex. Derivatives that are classified as liabilities).
- Entities are prohibited (as in IAS 39) from reclassifying financial liabilities between amortized cost and fair value. (Note: prohibition for reclassification does not relate to derivatives utilized in hedge accounting).

IFRS 9 PHASE 2: AMORTIZED COST AND IMPAIRMENT

IAS 39 requires impairments to be recognized under an incurred loss approach which results in credit losses being recognized when a loss event occurs. The IASB believes this approach results in profitability being overstated in earlier years because of the late recognition of credit losses. In November 2009, the IASB published an exposure draft for IFRS 9 Phase 2: Amortized Cost and Impairment. The exposure draft recommended moving away from the incurred loss approach to a lifetime expected loss approach resulting in the measurement of the impairment loss rather than identifying the loss event. Under this approach, the financial asset is subsequently recorded based on a return that reflects a deduction for initially expected credit losses which are not recognized under IAS 39. The exposure draft specified that an integrated effective interest rate (EIR) should be used to calculate amortized cost using expected cash flows including future credit losses. This calculation would avoid the overstatement of interest revenue in periods before a loss event occurs.

In December 2009, the IASB formed an Expert Advisory Panel (the Panel) to advise the IASB on the operational challenges for implementing the proposed requirements in the exposure draft. The Panel included representatives from major financial institutions, audit firms, securities regulators and other companies from around the world. The Financial Accounting Standards Board (FASB) also participated with the IASB on the Panel. The responses from the Panel and others stated that an integrated EIR is operationally difficult as many entities use separate credit risk systems and accounting systems, and it would be difficult to determine an integrated EIR in a cost-effective manner. As a result, various alternatives for decoupling the EIR (separating risk data from accounting data) were discussed with the IASB to support recognition of expected losses.

KEY PROPOSALS FOR THE EXPECTED LOSS APPROACH BEING EVALUATED

- **Decouple the EIR**

Two decoupling approaches developed by the Panel to avoid complexity of an integrated EIR calculation include:

- Straight Line Approach: Determine the expected Loss and allocate it over the life of the instrument using a straight-line method.
- Annuity Approach: Determine the present value of the expected loss by performing a discounted cash flow analysis. Establish an annuity, allocated over the life of the instrument, and recognize in profit and loss as a periodic charge.

- **Various Approaches/Models Being Evaluated for Allocation of Subsequent Changes in Expected Loss Estimate**

- Full Catch-Up:
Present value of changes in expected loss estimates would be recognized in profit or loss immediately.
- No-Catch-Up:
Spread the effect of all changes in the expected loss estimates over the remaining life using a straight line or annuity allocation.

- Partial Catch-Up:
Recognize in profit and loss the difference between the current balance of the allowance for expected losses and the time proportionate amount of total expected losses. Spread the change in expected losses over the current and future periods using a straight line or annuity allocation.
- Interaction of “Good Book” and “Bad Book” with Catch-Ups:
The “Bad Book” will have a full catch-up and the “Good Book” will have a full catch-up, partial catch-up or no catch-up. For the “Good Book”, the entire allowance to cover losses on the assets being transferred from the “Good Book” to the “Bad Book” or the proportionate amount of “Good Book” allowance recorded to date is allocated to the assets transferred to the “Bad Book” and an additional allowance is required to fully provide for the full-catch up in the “Bad Book.”

After reviewing various models for allocation of subsequent changes in expected loss estimates, the IASB proposed an approach to recognize lifetime expected credit losses using a time-proportionate approach for a “Good Book” and full recognition of lifetime expected losses for a “Bad Book.” This model was based on the approach the Panel put forward, and it maintains the relationship between interest and loss expectations that was a fundamental aspect of the IASB exposure draft.

The FASB originally proposed to recognize immediately, through an allowance account, all expected credit losses for the remaining life of an instrument. The FASB felt it was inappropriate to allocate an expected credit loss over the life of a financial asset and the loss should be recognized immediately. After considering various models for allocation of subsequent changes in expected loss estimates, the FASB proposed an approach for immediate recognition of credit losses in the foreseeable future with no minimum period identified. Foreseeable future represents the period for which reasonable and supportable information exists to support projections and conditions for credit losses.

COMMON PROPOSED SOLUTION FOR IASB AND FASB (FOR OPEN PORTFOLIOS)

The IASB and FASB have continued to work together to arrive at a common solution for the recognition of impairments. In January 2011, a supplement to the exposure draft was published by the IASB. The supplement “Financial Instruments: Impairment,” includes a common proposal for the IASB and FASB for open portfolios as well as the most recent approach recommended by each organization. The supplement to the exposure draft mentions that open portfolios include assets added to the portfolio through its life by origination or purchase and removed through its life by write-offs, transfers to other portfolios, sales and repayments. In a closed portfolio, assets are not added to the portfolio through its life.

THE COMMON PROPOSAL INCLUDED

Financial assets managed in open portfolios are divided into two groups, “Good Book” and “Bad Book,” for determining the credit allowance. For companies complying with IFRS, the proposals in this supplement, if implemented, will apply to financial assets measured at amortized cost and managed on an open portfolio basis (except short-term receivables without a stated interest rate). Estimates of expected credit losses for both the “Good Book” and “Bad Book” are

required to be updated at a minimum when an entity prepares its interim or annual financial statements. (Note: For companies complying with the FASB, the proposals in this supplement, if implemented, will apply to loans and debt instruments in open portfolios that are not measured at fair value with changes in value recognized in net income).

Recognition of Credit Losses for the “Good Book” equals the higher of:

- Time-proportional amount of remaining lifetime expected credit losses or
- All expected credit losses for the foreseeable future (minimum of 12 months unless remaining expected life is less than 12 months)

Therefore, the allowance for expected losses for the “Good Book” will never be less than a minimum allowance amount for the foreseeable future.

If the collectability of a financial asset (or group of financial assets) becomes so uncertain that the credit risk management objective changes to recovery of the investment, the asset(s) should now be included in the “Bad Book”. As a result, financial assets will be transferred between the two groups based on their internal risk management.

- Entities not managing credit risk based on collectability must still differentiate their assets between “Good Book” and “Bad Book” based on principles such as, days past due, expected return less than risk-free market rate, or asset classified as a problem investment.

Recognition of Credit Losses for “Bad Book”

Recognition of credit losses for “Bad Book” equals full amount of remaining lifetime expected credit losses.

Loss Estimates

Entities should consider internal and external data when determining credit loss estimates including, historical data, current economic conditions, and supportable forecasts of future events and economic conditions.

Time-Proportional Expected Credit Losses

Entity determines time-proportional expected credit losses by:

- Multiplying expected remaining credit losses by the percentage of portfolio’s weighted average age to its expected weighted average life using a discounted or undiscounted straight line approach
- Converting remaining expected losses into annuities based on expected life of the portfolio including accruing notional interest on the balance of the allowance account
- Using reasonable rate between the risk-free rate and the effective interest rate to determine the discounted expected loss

Other Proposals Outstanding

Some of the other proposals from both Boards' original exposure drafts that need to be redeliberated and are not included in this supplementary document include:

- Credit impairment requirements for financial assets not part of open portfolios or evaluated individually (Is a different model required)
- Methods for measuring credit losses
- Disclosure requirements
- Proposed definition of "write-off"
- Amortized cost measurement and relationship to impairment model
- Interest revenue recognition and concept of non-accrual

Disclosures

The supplement to the exposure draft issued in January 2011 also includes an Appendix Z related to presentation and disclosure for the IASB based on the impairment model proposed in this document. The disclosures in Appendix Z may need to be revisited based on the model that is ultimately approved. These disclosures will likely be included in IAS 7 "Presentation of Financial Statements" and IFRS 7 "Financial Instruments: Disclosures."

Comments on the proposals and/or questions included in the supplement to the exposure draft and/or appendix z are due by April 1, 2011. The IASB anticipates that IFRS 9 Phase 2 - Amortization and Impairment will be finalized by June 2011.

IFRS 9 PHASE 3: HEDGE ACCOUNTING

In December 2010, the IASB published the exposure draft "Hedge Accounting," which proposes significant changes to the hedge accounting requirements in IAS 39. The proposals include aligning hedge accounting more closely with risk management, establishing a more objective-based approach to hedge accounting and addressing inconsistencies and weaknesses in the existing hedge accounting model. The following paragraphs will identify some of the key hedging requirements and potential changes included in the exposure draft. The IASB is considering all comments related to the exposure draft that was received in writing by March 9, 2011.

New Stated Objective for Hedge Accounting

The exposure draft states, "The objective for hedge accounting is to represent in the financial statements the effect of an entity's risk management activities that use financial instruments to manage exposures arising from particular risks that could affect profit or loss." In establishing the objective for hedge accounting, the IASB wants readers of financial statements to have a better understanding of the entity's risk management activities and the related impact on the statement of financial position, statement of comprehensive income and effects of individual assets and liabilities associated with risk management activities.

Qualifying for Designation as Hedging Instruments

The following instruments qualify for designation as hedging instruments:

- Financial asset or a financial liability measured at fair value through profit or loss (exception for some written options)
- Hedge of foreign currency risk for financial asset or financial liability that is not to be measured at fair value through other comprehensive income

Note: The hedge relationship has to be with a party external to the reporting entity to qualify for hedge accounting treatment

Designation of Hedging Instruments

The hedging instrument must be designated in its entirety in a hedging relationship. (Exceptions: Designating as the hedging instrument (a) only the change in intrinsic value and not the change in time value of an option contract, and (b) only the change in the spot element of a forward contract.

A percentage of the nominal amount of the entire hedging instrument may be designated as the hedging instrument.

An entity may combine and jointly designate as the hedging instrument derivatives or a percentage of their nominal amounts or non-derivatives or a percentage of their nominal amounts.

Not Qualifying for Designation as Hedging Instruments

IAS 39 requires separation of non-closely related derivatives embedded in hybrid financial assets and liabilities and allows the separated derivative to be eligible for designation as a hedging instrument. However, IFRS 9 requires that hybrid financial assets are measured in their entirety and no separation of an embedded derivative is allowed. As a result, the exposure draft for hedge accounting prohibits derivatives features embedded in financial assets to be eligible hedging instruments.

IAS 39 permits non-derivative financial assets and non-derivative financial liabilities to be designated as hedging instruments for only a hedge of foreign currency risk. The exposure draft proposes that non-derivative financial instruments that are measured at fair value through profit or loss should be eligible hedging instruments in their entirety (not just for hedges of foreign currency risk).

As in IAS 39, the exposure draft proposes that (a) internal derivatives should not be eligible hedging instruments in the financial statements of the reporting entity, and (b) continues the restriction for not allowing intragroup monetary items to be eligible hedging instruments.

Qualifying for Designation as Hedged Items

Hedged item can be (a) a single asset, liability, firm commitment, highly probable forecast transaction or a net investment in a foreign operation, or (b) group of assets, liabilities, firm commitments, highly probable forecast transactions or net investments in foreign operations.

Designation of Hedged Items

An entity may designate as the hedged item: (a) all changes in the cash flows or fair value of an item or (b) only changes in the cash flows or fair value attributable to a specific risk or risks (risk component), one or more selected contractual cash flows, or specified part of the amount of an item (nominal component).

IAS 39 allows an entity to only designate foreign currency risk as a risk component for a non-financial hedged item. The exposure draft proposes that entities will be able to designate other risk components (not just foreign currency risk) for non-financial items. As a result, the exposure draft proposal is aligning the eligibility of risk components of non-financial items with financial items.

IAS 39 allows an entity to designate forecast transactions as hedged items for a layer component of a nominal amount. The exposure draft proposes to allow designation of a layer component of a nominal amount as the hedged item for forecast and existing transactions (excluding prepayment options in a fair value hedge if options fair value is affected by changes in the hedged risk).

As in IAS 39, the exposure draft allows (a) an entity to designate changes in the cash flows or fair value of a hedged item above or below a specified price or other variable (one-sided risk such as interest rate exposure above 5% and (b) an entity to designate a percentage component of a nominal amount as a hedged item (ex.50 percent of the entire investment).

Not Qualifying for Designation as a Hedged Item

Hedge accounting is prohibited for investments in equity instruments designated at fair value through other comprehensive income. However, a forecast dividend from these investments could be eligible as a hedged item since the dividends are recognized in profit or loss.

IAS 39 does not permit derivatives or aggregated exposures that include a derivative to be designated as hedged items (exception purchased option designated as a hedged item). The exposure draft proposes that an aggregated exposure including an instrument that has the characteristics of a derivative does not preclude designation as a hedged item.

Qualifying Criteria for Hedge Accounting

The exposure draft identifies the following qualifying criteria for hedge accounting:

- Only eligible hedging instruments and hedged items are included in the hedge
- Formal designation and documentation of the hedging relationship and the entity's risk management objective and strategy for the hedge are identified upon entering the hedge
- Hedging relationship meets the hedge effectiveness requirements

Hedge Effectiveness

The exposure draft identifies the following requirements for hedge effectiveness:

- Entity assesses if the hedge ratio (relationship between hedging instrument and hedged item) will minimize the expected ineffectiveness
- Entity assesses if expected offsetting changes in the fair value or cash flows in the hedging relationship are other than accidental
- Entity assesses hedge effectiveness at each reporting date, or earlier for significant changes that impact the hedge effectiveness requirements

Methods for Assessing Hedge Effectiveness

- An entity's risk management is the main source to determine for assessing hedge effectiveness
 - Management information (or analysis) can be used to assess hedging effectiveness
- Method for assessing hedge effectiveness is not specified
- Qualitative assessment when the critical terms of the hedged item and hedging instrument match or are closely aligned
- Quantitative assessment that depends on the complexity of the hedge, availability of data and the level of uncertainty of offset
- Proposal to eliminate from IAS 39 the 80-125 per cent "bright line" for testing whether a hedging relationship qualifies for hedge accounting.

ACCOUNTING FOR QUALIFYING HEDGES

Fair Value Hedges

IAS 39 requires that gain or loss from remeasuring the hedging instrument is recognized in profit or loss and gain or loss on the hedged item is recorded as an adjustment in the carrying amount of the hedged item and is recognized in profit or loss. The exposure draft proposes that the gain or loss from remeasuring the hedging instrument is recognized in other comprehensive income. The ineffective portion of the gain or loss from remeasuring the hedging instrument and the hedged item shall be transferred from other comprehensive income to profit or loss. This change from IAS 39 will result in presenting in other comprehensive income the effects of risk management activities for both cash flow and fair value hedges.

The exposure draft proposes the following additional changes from IAS 39:

- Hedging gain or loss on the hedged item presented as a separate line item in the statement of financial position and recognized in other comprehensive income. The hedging gain or loss is reported next to the line item that includes the hedged asset or liability.
- Hedging gain or loss is amortized to profit or loss if the hedged item is a financial instrument (or a component thereof) measured at amortized cost. Amortization can begin as soon as the adjustment exists or can begin no later than when the separate line item ceases to be adjusted for changes in the fair value of the hedged item. The amortization is based on a recalculated effective interest rate based on the carrying amounts of the separate line item and the related financial instrument.
- Ineffective portion of the gain or loss from remeasuring the hedging instrument and the hedged item should be transferred from other comprehensive income to profit or loss.
- Fair value hedge accounting should be available for financial instruments that are managed on a contractual cash flow basis (as described in IFRS 9). The Board concluded that a fair value hedge of interest rate risk would not contradict the assertion that a financial instrument is managed on a contractual cash flow basis.
- Entities can use the fair value of a hypothetical derivative to calculate the fair value of a hedged item.

Cash Flow Hedges

IAS 39 requires a “lower of” test to determine the amounts recognized for cash flow hedges in other comprehensive income (effective part) and profit or loss (ineffective part). The “lower of” test ensures that cumulative changes in the value of the hedged items that exceed cumulative fair value changes of the hedging instrument are not recognized in profit or loss. The exposure draft proposes that the “lower of” test is retained for cash flow hedges. As in IAS 39, a separate component of equity associated with the hedged item (now identified as cash flow hedge reserve) reflects the lower of (a) cumulative gain or loss on the hedging instrument from inception of the hedge, and (b) cumulative change in fair value of the hedged item from inception of hedge. The portion of gain or loss on the hedging instrument that is determined to be an effective hedge is recognized in other comprehensive income and any remaining gain or loss representing hedge ineffectiveness is recognized in profit or loss.

Regarding situations where hedge accounting is discontinued for a cash flow hedge: (a) if the hedged future cash flows are expected to occur, the amount remains in the cash flow hedge reserve until the future cash flows occur, or (b) if the

hedged future cash flows are no longer expected to occur, the amount in the cash flow hedge reserve is reclassified to profit or loss.

IAS 39 allowed two options for hedges of forecast transactions that result in recognition of a non-financial asset or a non-financial liability:

- Basis adjustment for adjusting initial cost on the non-financial asset or non-financial liability
- Reclassify gains and losses from other comprehensive income to profit and loss in the same period during which the non-financial asset acquired or non-financial liability assumed affects profit or loss.

The exposure draft proposes that only basis adjustments are allowed for hedges of forecast transactions that result in recognition of a non-financial asset or a non-financial liability.

Hedges of a Net Investment in a Foreign Operation

The IASB decided to retain the requirements of IAS 39 and not address a hedge of a net investment in a foreign operation as part of Phase 3.

As a result, the portion of gain or loss on the hedging instrument that is determined as an effective hedge is recognized in other comprehensive income. In addition, the ineffective portion of hedge is recognized in profit or loss and the gain or loss on the hedging instrument relating to the effective portion of the hedge (in cash flow hedge reserve) is reclassified from equity to profit or loss on the disposal or partial disposal of the foreign operation.

Hedge of Foreign Currency Risk of a Firm Commitment

As in IAS 39, the exposure draft proposes to continue the choice of accounting for a hedge of foreign currency risk of a firm commitment as a fair value hedge or as a cash flow hedge.

Hedging Relationship Ceases to Meet Objective of Hedge Effectiveness Assessment

IAS 39 does not allow adjustments that were not documented at the inception of the hedge to be treated as adjustments to an existing hedging relationship. The exposure draft proposes that if the risk management objective for the designated hedging relationship remains the same, an entity shall be required to rebalance the hedge relationship to meet qualifying criteria again. In addition, the exposure draft proposes to permit voluntary rebalancing to ensure that the hedging relationship will continue to qualify for hedge accounting.

Discontinuing Hedge Accounting

IAS 39 requires that an entity must discontinue hedge accounting when the hedging relationship ceases to meet the qualifying criteria or when the entity voluntarily discontinues hedge accounting. The exposure draft proposes that an entity should only discontinue hedge accounting prospectively when the hedging relationship ceases to meet the qualifying criteria, after considering rebalancing, if applicable. In addition, an entity should not be permitted to

discontinue hedge accounting for a hedging relationship that still meets the risk management objective and strategy and continues to meet the qualifying criteria.

Hedges of a Group of Items

IAS 39 restricts the application of hedge accounting for groups of items that qualify for hedge accounting for the same hedged risk on an individual basis. Additionally under IAS 39, net positions cannot be designated as the hedged item in a hedging relationship. The exposure draft proposes that groups of items (including net positions) are eligible as the hedged item if:

- (a) The group consists of items that individually are eligible hedged items.
- (b) Items in group are managed together on a group basis for risk management purposes.
- (c) For cash flow hedge accounting, any offsetting cash flows in the group of hedged items exposed to the hedge risk affect profit and loss the same and only in that reporting period.

Disclosures

The exposure draft proposes a new set of hedge accounting disclosures that include:

- Entity's risk management strategy and how it is applied to manage risk
- Quantitative information explaining how entity's risk management strategy for each risk exposure affects the amount, timing and uncertainty of its future cash flows.
 - Risk exposures and effect of hedging strategy
 - Hedging relationship affect on profit or loss
 - Sources of hedge ineffectiveness expected
- Effect of hedge accounting on entity's financial statements separated by risk and type of hedge for hedging instruments and hedged items

When the disclosure requirements are finalized, they will be incorporated into IFRS 7 "Financial Instruments: Disclosures."

Effective Date and Transition

An entity will be required to apply these IFRS requirements prospectively for annual periods beginning on or after January 1, 2013 (with earlier application permitted). To apply, hedge accounting from date of adoption of this IFRS, all qualifying criteria must be met as of that date. Hedging relationships that qualified for hedge accounting under IAS 39 that also qualify for hedge accounting under this IFRS shall be regarded as continuing hedging relationships.

Estimated Completion Date

The IASB expects to complete IFRS 9 for Phase 3 in the first half of 2011.

SUMMARY

The requirements approved in Phase 1 and proposed for Phases 2 and 3 will result in many changes to accounting for financial instruments and will have significant system and operational implications. Phase 1 includes new IFRS regulatory classifications and measurements to be established based on your business model for managing your financial assets and recording your financial liabilities. It also includes several irrevocable elections at initial recognition to report changes in fair value, and the requirements to (a) carry unquoted equity investments at fair value, (b) apply a regulatory classification to the entire hybrid contract, and (c) allow reclassifications between regulatory categories only upon a change in your business model.

Phase 2 includes a proposed solution for the recognition of impairments including estimates of expected credit losses for open portfolios divided into two groups “Good Book” and “Bad Book”, recognition of credit losses for “Good Book” based on the time-proportional amount of lifetime expected credit losses or a floor amount based on credit losses for the foreseeable future, and recognition of full amount of remaining lifetime expected credit losses for the “Bad Book.”

Phase 3 proposes significant changes to the hedge requirements in IAS 39, including aligning hedge accounting more closely with risk management, eligibility for hedging instruments or hedged items, assessing hedge effectiveness, recognition and reporting for fair value hedges rebalancing hedging relationships, discontinuing hedge accounting, hedging a group of items, and improved hedge accounting disclosures relating to risk management and the link between other comprehensive income and the income statement.

In addition to these approved and/or proposed changes, the IASB and the FASB will continue to work together on joint projects to improve accounting for financial instruments. Due to the difference in timetables for developing the standards for these two organizations, some variations in requirements are likely to occur. These discrepancies will require additional analysis and comparison in the future and will likely lead to additional changes in the accounting for financial instruments within IFRS 9. It is imperative that entities are knowledgeable about finalized and current proposed changes and are able to adopt these requirements on a timely and accurate basis. Being aware of these requirements, as they are being discussed, evaluated and finalized will allow companies to anticipate and implement on a timely basis the necessary changes from an operational and system perspective to support business operations. So, when the question is asked, and it will be, “are you getting ready for IFRS 9,” your answer will be a resounding “YES!”

SOURCES

IFRS 9 Financial Instruments issued by IASB in November, 2009 and further updated in October, 2010.

IFRS 9 Financial Instruments - Basis for Conclusions accompanies IFRS 9 and published by IASB in October, 2010.

IFRS 9 Financial Instruments - Implementation Guidance accompanies IFRS 9 and published by IASB in October, 2010.

Financial Instruments: Amortized Cost and Impairment - exposure draft issued by IASB in November, 2009.

Financial Instruments: Amortized Cost and Impairment - Basis for Conclusions accompanies related exposure draft and published by IASB in November, 2009.

Financial Instruments: Impairment - Supplement to exposure draft Financial Instruments: Amortized Cost and Impairment published by IASB in January, 2011.

Staff Papers from IASB for Amortized Cost and Impairment issued in 2010.

Hedge Accounting - exposure draft issued by IASB in December, 2010.

Hedge Accounting - Basis for Conclusions accompanies related exposure draft and published by IASB in December, 2010.



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