

FINANCIAL REPORTING
EXPOSURE DRAFT

IMPROVEMENTS
TO FINANCIAL REPORTING
STANDARDS

2009



ACCOUNTING
STANDARDS
BOARD

This draft is issued by the Accounting Standards Board for comment. It should be noted that the draft may be modified in the light of comments received before being issued in final form.

For ease of handling, we prefer comments to be sent by email (in Word format) to

asbcommentletters@frc-asb.org.uk

Comments may also be sent in hard copy form to:

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Comments should be despatched so as to be received no later than 30 September 2009. All replies will be regarded as on the public record, unless confidentiality is requested by the commentator.

The FRC's policy is to publish on its website all responses to formal consultations issued by the FRC and/or any of its operating bodies unless the respondent explicitly requests otherwise. A standard confidentiality statement in an email message will not be regarded as a request for non-disclosure. We do not edit personal information (such as telephone numbers or email addresses) from submissions; therefore only information that you wish to be published should be submitted.

We aim to publish responses within 10 working days of receipt.

We will publish a summary of the consultation responses, either as part of, or alongside, our final decision.

**FINANCIAL REPORTING
EXPOSURE DRAFT**

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FINANCIAL REPORTING
STANDARDS
2009**



**ACCOUNTING
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BOARD**

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PREFACE

Introduction

- 1 In April 2009, the International Accounting Standards Board (IASB) issued an International Financial Reporting Standard (IFRS) ‘Improvements to IFRSs’ which amended several IFRS. The amendments were the result of the IASB annual improvement process and included changes from both the 2007 and 2008 improvement cycles.
- 2 As part of its ongoing commitment to ensure the robustness and relevance of UK and Republic of Ireland Financial Reporting Standards (FRS)*, the Accounting Standards Board (ASB) also conducts an annual review. The review process is driven principally by the amendments made by the IASB to IFRS. However, consideration is also given to other financial reporting issues raised by constituents. This Financial Reporting Exposure Draft (FRED) is being issued to respond to both those signals to improve UK GAAP.
- 3 The Board has attempted to limit the number of changes to UK GAAP given its current deliberations on the future of UK GAAP and its longer term ambitions to converge UK GAAP with IFRS.
- 4 The Board has decided not to include editorial changes to FRS in this FRED as they do not alter financial reporting requirements and constituents commenting on the previous FRED ‘Improvements to Financial Reporting Standards’ (2008) suggested that the presentation of proposed changes should be simplified.

* Hereafter the term ‘UK GAAP’ is used to refer to Financial Reporting Standards in the United Kingdom and the Republic of Ireland.

Accordingly, editorial changes to FRS have been posted on the Board's website at www.frc.org.uk/asb.

Structure of the FRED

- 5 The FRED is presented in two sections. The first section sets out proposed amendments to FRS as part of the Board's review of its standards. The second section presents proposed amendments resulting from the IASB's changes to IFRS.

Regulatory Impact

- 6 In the ASB's view, the proposals set out in this FRED should not impose significant additional costs of preparation. The ASB believes that the amendments will result in information which is of benefit to users of the financial statements. The ASB, however, would welcome views on whether there are any significant costs resulting from these proposals and, if so, whether they can be quantified. The ASB would also welcome views on whether the benefits arising from the proposals in this FRED outweigh any costs involved.

Date from which effective

- 7 The proposed amendments to FRS identify the date from which it is proposed the amendment becomes effective.

Invitation to Comment

- 8 The Board is requesting comments on this FRED by 30 September 2009. Comments will be most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, a suggestion of alternative wording.

Question 1

The proposals set out in this FRED seek to implement the amendments made by the IASB from its annual improvement project. Do you agree with the ASB proposals for the implementation of these changes to UK GAAP? If not, please explain why.

Question 2

In addition, the FRED proposes amendments specific to the UK GAAP. Do you agree with the ASB proposals for the implementation of these changes to UK GAAP? If not, please explain why.

Question 3

Constituents often make the point in their comment letters that the ASB should ensure that FRS that are converged with IFRS should remain so and that any amendments made by the IASB should flow through into UK GAAP. Some argue that there are significant benefits for both preparers and users in ensuring consistency between both sets of standards. Overall, the ASB believes that the changes proposed in this FRED will lead to an improvement in the quality of financial reports prepared under UK GAAP. Do you agree with the Board's assertion that these proposals will have a positive effect on the quality of financial reporting? If not, please explain why.

Question 4

Are there any other changes to UK GAAP that the Board should consider in its next cycle of annual improvements? If so, what are they and how do you think financial reporting will be improved if those issues are addressed?

Question 5

The ASB considers that the benefits of implementing the proposals in this FRED will outweigh the costs involved. Do you agree? If not, why not? It would be helpful if any significant costs that would arise on implementation of the proposals could be identified and quantified.

DRAFT IMPROVEMENTS TO FINANCIAL REPORTING STANDARDS – SPECIFIC UK AMENDMENTS

Amendment to Financial Reporting Standard 11 ‘Impairment of fixed assets and goodwill’

As part of its annual review of UK GAAP the ASB is proposing to amend FRS 11 to strengthen the disclosure requirements in that standard. These changes are similar in nature to those made by the IASB to IAS 36 ‘Impairment of Assets’ as part of its ‘Improvements to IFRS’ issued in 2008.

Paragraph 69 is amended (new text is underlined, deleted text is struck through) and paragraph 75A is added.

- 69 If the impairment loss is measured by estimating the reference to value in use or the net realisable value of a fixed asset or income-generating unit, the discount rate applied to the cash flows should be disclosed. If the risk-free discount rate is used, some indication of the risk adjustments made to the cash flows should be given. The key assumptions management has made in determining those estimated amounts should also be disclosed.
- 75A Paragraph 69 was amended by ‘Improvements to Financial Reporting Standards’ issued in [Month] 2009. The requirement set out in that paragraph should be applied in annual periods beginning on or after 1 January 2010. Earlier application is permitted.

DRAFT IMPROVEMENTS TO FINANCIAL REPORTING STANDARDS ARISING FROM INTERNATIONAL FINANCIAL REPORTING STANDARDS

Amendment to Financial Reporting Standard 20 (IFRS 2) ‘Share-based Payment’

The IASB amended IFRS 2 to change the scope of the standard and clarify that it does not apply to common control transactions or the contribution of a business in the formation of a joint venture.

The ASB is proposing the following amendments to FRS 20.

Paragraphs 5 and 61 are amended to read as follows.

Scope

- 5 As noted in paragraph 2, this ~~FRS~~IFRS... However, an entity shall not apply this ~~FRS~~IFRS to transactions in which the entity acquires goods as part of the net assets acquired in a business combination to which FRS 6 Acquisitions and mergers applies as defined by IFRS 3 *Business Combinations* (as revised in 2008), in a combination of entities or businesses under common control as described in paragraphs B1–B4 of IFRS 3, or the contribution of a business—an entity on the formation of a joint venture as defined by FRS 9 ‘Associates and joint ventures’ IAS 31 *Interests in Joint Ventures*. Hence, equity instruments issued ... (and therefore within the scope of this ~~FRS~~IFRS).

Effective date

- 61 Paragraph 5 was amended by ‘Improvements in Financial Reporting Standards’ issued in [month] 2009~~IFRS 3 (as revised in 2008) and *Improvements to IFRSs* issued in April~~

~~2009 amended paragraph 5.~~ An entity shall apply those amendments for annual periods beginning on or after 1 January 2010. Earlier application is permitted. ~~If an entity applies IFRS 3 (revised 2008) for an earlier period, the amendments shall also be applied for that earlier period.~~

Amendment to Basis for Conclusions on Financial Reporting Standard 20 (IFRS 2) ‘Share-based Payment’*

Paragraphs BC24A–BC24D are added.

Transactions within the scope of IFRS 3 *Business Combinations*

BC24A IFRS 3 (as revised in 2008) changed the definition of a business combination. The previous definition of a business combination was ‘the bringing together of separate entities or businesses into one reporting entity’. The revised definition of a business combination is ‘a transaction or other event in which an acquirer obtains control of one or more businesses’.

BC24B The Board was advised that the changes to that definition caused the accounting for the contribution of a business in exchange for shares issued on formation of a joint venture by the venturers to be within the scope of IFRS 2. The Board noted that common control transactions may also be within the scope of IFRS 2 depending on which level of the group reporting entity is assessing the combination.

BC24C The Board noted that during the development of revised IFRS 3 it did not discuss whether it intended IFRS 2 to apply to these types of transactions. The Board also noted that the reason for excluding common control transactions and the accounting by a joint venture upon its formation from the scope of revised IFRS 3 was to give the Board more time to consider the relevant accounting issues. When the Board revised IFRS 3, it did not intend to

* *ASB Note: The IASB amendment to the Basis for Conclusions to IFRS 2 is reproduced here to maintain consistency as FRS 20 is a converged FRS. Under UK GAAP ‘group reconstruction’ is the nearest equivalent in the literature to the IASB’s discussion here of common control.*

change existing practice by bringing such transactions within the scope of IFRS 2, which does not specifically address them.

- BC24D Accordingly, in *Improvements to IFRSs* issued in April 2009, the Board amended paragraph 5 of IFRS 2 to confirm that the contribution of a business on the formation of a joint venture and common control transactions are not within the scope of IFRS 2.

Amendment to Financial Reporting Standard 26 (IAS 39) *Financial Instruments: Recognition and Measurement*

The IASB made various amendments to IAS 39 to address treating loan prepayment penalties as closely related embedded derivatives, providing a scope exemption for business combination contracts and clarifying the operation of hedge accounting.

The ASB is proposing the following amendments to FRS 26 as set out below.

Paragraphs 2(g), 80, 97, 100 and 108J are amended to read as follows and paragraph 103K is added.

Scope

2 This Standard shall be applied by all entities to all types of financial instruments except:

(a) ...

(g) any forward contracts between an acquirer and a selling shareholder to buy or sell an acquiree that will result in a business combination at a future acquisition date. The term of the forward contract should not exceed a reasonable period normally necessary to obtain any required approvals and to complete the transaction.

(h) ...

Hedging

Hedged items

Qualifying items

- 80 For hedge accounting purposes, only assets, liabilities, firm commitments or highly probable forecast transactions that involve a party external to the entity can be designated as hedged items. It follows that hedge accounting can be applied to transactions between entities in the same group only in the individual or separate financial statements of those entities and not in the consolidated financial statements of the group. As an exception ...

Hedge accounting

Cash flow hedges

- 97 **If a hedge of a forecast transaction subsequently results in the recognition of a financial asset or a financial liability, the associated gains or losses that were recognised through the statement of total recognised gains and losses in other comprehensive income in accordance with paragraph 95 shall be reclassified from equity to into profit or loss as a reclassification adjustment (see IAS 1 (as revised in 2007)) in the same period or periods during which the hedged forecast cash flows affects profit or loss (such as in the periods that interest income or interest expense is recognised). However, if an entity expects that all or a portion of a loss recognised through the statement of total recognised gains and losses in other comprehensive income will not be recovered in one or more future periods, it shall recognise into profit or loss as a reclassification adjustment the amount that is not expected to be recovered.**
- 100 For cash flow hedges other than those covered by paragraphs 97 and 98, amounts that had been

recognised in reserves ~~other comprehensive income~~ shall be recognised in reclassified from equity to profit or loss as a reclassification adjustment (see IAS 1 ~~(revised 2007)~~) in the same period or periods during which the hedged forecast cash flows affects profit or loss (for example, when a forecast sale occurs).

Effective date and transition

103K ‘Improvements in Financial Reporting Standards’ ~~Improvements to IFRSs~~ issued in ~~April~~ [month] 2009 amended paragraphs 2(g), 97, 100 and AG30(g). An entity shall apply the amendments to paragraphs 2(g), 97 and 100 prospectively to all unexpired contracts for annual periods beginning on or after 1 January 2010. An entity shall apply the amendment to paragraph AG30(g) for annual periods beginning on or after 1 January 2010. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact.

108JG Paragraphs 9, 73 and AG8 were amended and paragraph 50A added by *Improvements to FRS* issued in May 2008. Paragraph 80 was amended by ‘Improvements in Financial Reporting Standards’ ~~Improvements to IFRSs~~ issued in [month] ~~April~~ 2009. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. An entity shall apply the amendments in paragraphs 9 and 50A as of the date and in the manner it applied the 2005 amendments described in paragraph 105A. Earlier application of all the amendments is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact.

Amendment to Application Guidance on Financial Reporting Standard 26 (IAS 39) *Financial Instruments: Recognition and Measurement*

Paragraph AG30(g) is amended to read as follows.

Embedded derivatives (paragraphs 10–13)

AG30 The economic characteristics and risks of an embedded derivative are not closely related to the host contract (paragraph 11(a)) in the following examples. In these examples, assuming the conditions in paragraph 11(b) and (c) are met, an entity accounts for the embedded derivative separately from the host contract.

...

- (g) A call, put, or prepayment option embedded in a host debt contract or host insurance contract is not closely related to the host contract unless:
 - (i) the option's exercise price is approximately equal on each exercise date to the amortised cost of the host debt instrument or the carrying amount of the host insurance contract; or
 - (ii) the exercise price of a prepayment option reimburses the lender for an amount up to the approximate present value of lost interest for the remaining term of the host contract. Lost interest is the product of the principal amount prepaid multiplied by the interest rate differential. The interest rate differential is the excess of the effective interest rate of the host contract over the effective interest rate the entity would receive at the prepayment date if it reinvested the principal amount prepaid in a similar contract for the remaining term of the host contract.

The assessment of whether the call or put option is closely related to the host debt contract is made before separating the equity element of a convertible debt instrument in accordance with FRS 25 ~~IAS 32~~.

(h) ...

Amendment to Basis for Conclusions on Financial Reporting Standard 26 (IAS 39) *Financial Instruments: Recognition and Measurement*

A heading, paragraphs BC24A–BC24E, a heading and paragraphs BC40B, BC40C and BC161A–BC161G are added. Paragraphs BC165, BC172 and BC172A are amended (new text is underlined and deleted text is struck through).

Scope

Business combination forward contracts

- BC24A The Board was advised that there was diversity in practice regarding the application of the exemption in paragraph 2(g) of IAS 39. Paragraph 2(g) applies to particular contracts associated with a business combination and results in those contracts not being accounted for as derivatives while, for example, necessary regulatory and legal processes are being completed.
- BC24B As part of the *Improvements to IFRSs* issued in April 2009, the Board concluded that paragraph 2(g) should be restricted to forward contracts between an acquirer and a selling shareholder to buy or sell an acquiree in a business combination at a future acquisition date and should not apply to option contracts, whether or not currently exercisable, that on exercise will result in control of an entity.
- BC24C The Board concluded that the purpose of paragraph 2(g) is to exempt from the provisions of IAS 39 contracts for business combinations that are firmly committed to be completed. Once the business combination is consummated, the entity follows the requirements of IFRS 3. Paragraph 2(g) applies only when completion of the business combination is not dependent on further

actions of either party (and only the passage of a normal period of time is required). Option contracts allow one party to control the occurrence or non-occurrence of future events depending on whether the option is exercised.

BC24D Several respondents to the exposure draft expressed the view that the proposed amendment should also apply to contracts to acquire investments in associates, referring to paragraph 20 of IAS 28. However, the acquisition of an interest in an associate represents the acquisition of a financial instrument. The acquisition of an interest in an associate does not represent an acquisition of a business with subsequent consolidation of the constituent net assets. The Board noted that paragraph 20 of IAS 28 explains only the methodology used to account for investments in associates. This should not be taken to imply that the principles for business combinations and consolidations can be applied by analogy to accounting for investments in associates and joint ventures. The Board concluded that paragraph 2(g) should not be applied by analogy to contracts to acquire investments in associates and similar transactions. This conclusion is consistent with the conclusion the Board reached regarding impairment losses on investments in associates as noted in the *Improvements to IFRSs* issued in May 2008 and stated in paragraph BC27 of the Basis for Conclusions on IAS 28.

BC24E Some respondents to the exposure draft raised concerns about the proposed transition requirement. The Board noted that determining the fair value of a currently outstanding contract when its inception was before the effective date of this amendment would require the use of hindsight and might not achieve comparability. Accordingly, the Board decided not to require retrospective application. The Board also rejected applying the amendment prospectively only to new contracts entered into after the effective date because that would create a lack of comparability between contracts outstanding as of the effective date and

contracts entered into after the effective date. Therefore, the Board concluded that the amendment to paragraph 2(g) should be applied prospectively to all unexpired contracts for annual periods beginning on or after 1 January 2010.

Embedded derivatives

Embedded prepayment penalties (paragraph AG30(g))

BC40B The Board identified an apparent inconsistency in the guidance in IAS 39. The inconsistency related to embedded prepayment options in which the exercise price represented a penalty for early repayment (ie prepayment) of the loan. The inconsistency related to whether these are considered closely related to the loan.

BC40C The Board decided to remove this inconsistency by amending paragraph AG30(g). The amendment makes an exception to the examples in paragraph AG30(g) of embedded derivatives that are not closely related to the underlying. This exception is in respect of prepayment options, the exercise prices of which compensate the lender for the loss of interest income because the loan was prepaid. This exception is conditional on the exercise price compensating the lender for loss of interest by reducing the economic loss from reinvestment risk.

Hedging

BC161A If a hedged forecast transaction results in the recognition of a financial asset or a financial liability, paragraph 97 of IAS 39 required the associated gains or losses on hedging instruments to be reclassified from equity to profit or loss as a reclassification adjustment in the same period or periods during which the hedged item affects profit or loss (such as in the periods that interest income or interest expense is recognised).

BC161B The Board was informed that there was uncertainty about how paragraph 97 should be applied when the designated cash flow exposure being hedged differs from the financial instrument arising from the hedged forecast cash flows.

BC161C The example below illustrates the issue:

An entity applies the guidance in the answer to Question F.6.2 of the guidance on implementing IAS 39. On 1 January 20X0 the entity designates forecast cash flows for the risk of variability arising from changes in interest rates. Those forecast cash flows arise from the repricing of existing financial instruments and are scheduled for 1 April 20X0. The entity is exposed to variability in cash flows for the three-month period beginning on 1 April 20X0 attributable to changes in interest rate risk that occur from 1 January 20X0 to 31 March 20X0.

The occurrence of the forecast cash flows is deemed to be highly probable and all the other relevant hedge accounting criteria are met.

The financial instrument that results from the hedged forecast cash flows is a five-year interest-bearing instrument.

BC161D Paragraph 97 required the gains or losses on the hedging instrument to be reclassified from equity to profit or loss as a reclassification adjustment in the same period or periods during which the asset acquired or liability assumed affected profit or loss. The financial instrument that was recognised is a five-year instrument that will affect profit or loss for five years. The wording in paragraph 97 suggested that the gains or losses should be reclassified over five years, even though the cash flows designated as the hedged item were hedged for the effects of interest rate changes over only a three-month period.

- BC161E The Board believes that the wording of paragraph 97 did not reflect the underlying rationale in hedge accounting, ie that the gains or losses on the hedging instrument should offset the gains or losses on the hedged item, and the offset should be reflected in profit or loss by way of reclassification adjustments.
- BC161F The Board believes that in the example set out above the gains or losses should be reclassified over a period of three months beginning on 1 April 20X0, and not over a period of five years beginning on 1 April 20X0.
- BC161G Consequently, in *Improvements to IFRSs* issued in April 2009, the Board amended paragraph 97 of IAS 39 to clarify that the gains or losses on the hedged instrument should be reclassified from equity to profit or loss during the period that the hedged forecast cash flows affect profit or loss. The Board also decided that to avoid similar confusion paragraph 100 of IAS 39 should be amended to be consistent with paragraph 97.

Hedging using internal contracts

- BC165 IAS 39 does not preclude entities from using internal contracts as a risk management tool, or as a tracking device in applying hedge accounting for external contracts that hedge external positions. Furthermore, IAS 39 permits hedge accounting to be applied to transactions between entities in the same group ~~or between segments~~ in the *separate reporting* of those entities ~~or segments~~. However, IAS 39 does not permit hedge accounting for transactions between entities in the same group in consolidated financial statements. The reason is the fundamental requirement of consolidation that the accounting effects of internal contracts should be eliminated in consolidated financial statements, including any internally generated gains or losses. Designating internal contracts as hedging instruments could result in non-elimination of internal gains and losses and have other accounting effects. The Exposure Draft did not propose any change in this area.

- BC172 The Board also decided to clarify that IAS 39 does not preclude hedge accounting for transactions between entities in the same group ~~or transactions between segments~~ in individual or separate financial statements of those entities ~~or reporting segments~~ because they are not internal to the entity (ie the individual entity ~~or segment~~).
- BC172A Previously, paragraphs 73 and 80 referred to the need for hedging instruments to involve a party external to the reporting entity. In doing so, ~~it~~ they used a segment as an example of a reporting entity. However, IFRS 8 *Operating Segments* requires disclosure of information that is reported to the chief operating decision maker even if this is on a non-IFRS basis. Therefore, the two IFRSs appeared to conflict. In *Improvements to IFRSs* issued in May 2008 and April 2009, the Board removed from paragraphs 73 and 80 references to the designation of hedging instruments at the segment level.

Amendment to guidance on implementing Financial Reporting Standard 26 (IAS 39) *Financial Instruments: Recognition and Measurement*

The answer to Question F.6.2 is amended to read as follows.

F.6.2 Hedge accounting considerations when interest rate risk is managed on a net basis

Issue (j) – For cash flow hedges, if a derivative is used to manage a net exposure to interest rate risk and the derivative is designated as a cash flow hedge of forecast interest cash flows or portions of them on a gross basis, does the occurrence of the hedged forecast transaction give rise to an asset or liability that will result in a portion of the hedging gains and losses that were recognised in other comprehensive income remaining in equity?

No. In the hedging relationship described in Issue (c) above, the hedged item is a group of forecast transactions consisting of interest cash flows in specified future periods. The hedged forecast transactions do not result in the recognition of assets or liabilities and the effect of interest rate changes that are designated as being hedged is recognised in profit or loss in the period in which the forecast transactions occur. Although this is not relevant for the types of hedges described here, if instead the derivative is designated as a hedge of a forecast purchase of a financial asset or issue of a financial liability, the associated gains or losses that were recognised in other comprehensive income are reclassified from equity to profit or loss in the same period or periods during which the hedged forecast cash flows affects profit or loss (such as in the periods that interest expenses are recognised). However, if an entity expects at any time that all or a portion of a loss recognised through the statement of total recognised gains and losses in other comprehensive income will not be recovered in one or more future periods, it shall reclassify immediately from equity to profit or loss the amount that is not expected to be recovered.

Amendment to IFRIC Abstract 42 (IFRIC 9)

Reassessment of Embedded Derivatives

The IASB amended IFRIC Interpretation 9 to clarify that it does not apply to embedded derivatives in contracts within the scope of IFRS 3.

The ASB is proposing to amend IFRIC Abstract 42 as set out below.

Paragraph 5 is amended to read as follows and paragraph 11 is added.

Scope

- 5 This Abstract does not apply to embedded derivatives in contracts acquired in:
- (a) a business combination (as defined in FRS 6 'Acquisitions and mergers' ~~IFRS 3 *Business Combinations* as revised in 2008~~); or
 - (b) a group reconstruction (as defined in FRS 6 'Acquisitions and mergers') ~~a combination of entities or businesses under common control as described in paragraphs B1-B4 of IFRS 3 (revised 2008); or [not used]~~
 - (c) the formation of a joint venture as defined in FRS 9 'Associates and joint ventures' ~~IAS 31 *Interests in Joint Ventures*~~

or their possible reassessment at the date of acquisition.*

* *IFRS 3 (as revised in 2008) addresses the acquisition of contracts with embedded derivatives in a business combination.*

Effective date and transition

- 11 Paragraph 5 was amended by 'Improvements in Financial Reporting Standards' ~~Improvements to IFRSs~~ issued in ~~April~~[month] 2009. An entity shall apply that amendment prospectively for annual periods beginning on or after 1 ~~January 2010~~ July 2009. ~~If an entity applies IFRS 3 (as revised in 2008) for an earlier period, it shall apply the amendment for that earlier period and disclose that fact.~~

Amendment to the Basis for Conclusions on UITF Abstract 42 (IFRIC 9) *Reassessment of Embedded Derivatives*

Paragraphs BC5A–BC5D are added.

Introduction

- BC5A In 2009 the International Accounting Standards Board observed that the changes to the definition of a business combination in the revisions to IFRS 3 *Business Combinations* (as revised in 2008) caused the accounting for the formation of a joint venture by the venturer to be within the scope of IFRIC 9. Similarly, the Board noted that common control transactions might raise the same issue depending on which level of the group reporting entity is assessing the combination.
- BC5B The Board observed that during the development of the revised IFRS 3, it did not discuss whether it intended IFRIC 9 to apply to those types of transactions. The Board did not intend to change existing practice by including such transactions within the scope of IFRIC 9. Accordingly, in *Improvements to IFRSs* issued in April 2009, the Board amended paragraph 5 of IFRIC 9 to clarify that IFRIC 9 does not apply to embedded derivatives in contracts acquired in a combination between entities or businesses under common control or the formation of a joint venture.
- BC5C Some respondents to the exposure draft *Post-implementation Revisions to IFRIC Interpretations* issued in January 2009 expressed the view that investments in associates should also be excluded from the scope of IFRIC 9. Respondents noted that paragraphs 20–23 of IAS 28 *Investments in Associates* state that the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for the acquisition of an investment in an associate.

BC5D In its redeliberations, the Board confirmed its previous decision that no scope exemption in IFRIC 9 was needed for investments in associates. However, in response to the comments received, the Board noted that reassessment of embedded derivatives in contracts held by an associate is not required by IFRIC 9 in any event. The investment in the associate is the asset the investor controls and recognises, not the underlying assets and liabilities of the associate.

Amendment to UITF Abstract 46 (IFRIC 16) *Hedges of a Net Investment in a Foreign Operation*

The IASB amended IFRIC Interpretation 16 to remove a restriction on the entity that can hold hedging instruments.

The ASB is proposing to amend UITF Abstract 46 as set out below.

Paragraphs 14 and 18 are amended to read as follows.

Consensus

Where the hedging instrument can be held

- 14 A derivative or a non-derivative instrument (or a combination of derivative and non-derivative instruments) may be designated as a hedging instrument in a hedge of a net investment in a foreign operation. The hedging instrument(s) may be held by any entity or entities within the group, as long as the designation, documentation and effectiveness requirements of FRS 26 IAS 39 paragraph 88 that relate to a net investment hedge are satisfied. In particular, the hedging strategy of the group should be clearly documented because of the possibility of different designations at different levels of the group.

Effective date

- 18 An entity shall apply this Abstract Interpretation for annual periods beginning on or after 1 October 2008. An entity shall apply the amendment to paragraph 14 made by 'Improvements to Financial Reporting Standards' Improvements to IFRSs issued in April[month] 2009 for annual periods beginning on or after 1 January 2010~~July 2009~~. Earlier application of both is permitted. If an entity applies this Interpretation for a period beginning before 1 October 2008, or the amendment to paragraph 14 before 1 January 2010 ~~July 2009~~, it shall disclose that fact.

Amendment to Basis for Conclusions on IFRIC Interpretation 16 *Hedges of a Net Investment in a Foreign Operation*

Paragraph BC24 is deleted (new text is underlined and deleted text is struck through). A footnote, paragraphs BC24A–BC24D, a heading and paragraph BC40A are added.

Consensus

Hedging instrument

Location of the hedging instrument (paragraph 14) and assessment of hedge effectiveness (paragraph 15)

BC24 ~~The IFRIC concluded that the foreign operation being hedged could not hold the hedging instrument because that instrument would be part of, and denominated in the same currency as, the net investment it was intended to hedge. In this circumstance, hedge accounting is unnecessary. The foreign exchange differences between the parent's functional currency and both the hedging instrument and the functional currency of the net investment will automatically be included in the group's foreign currency translation reserve as part of the consolidation process. The balance of the discussion in this Basis for Conclusions does not repeat this restriction.*~~

* Paragraph BC24 was deleted and paragraphs BC24A–BC24D and paragraph BC40A added as a consequence of *Improvements to IFRSs* issued in April 2009.

BC24A Paragraph 14 of IFRIC 16 originally stated that the hedging instrument could not be held by the foreign operation whose net investment was being hedged. The restriction was included in draft Interpretation D22 (from which IFRIC 16 was developed) and attracted little comment from respondents. As originally explained in paragraph BC24, the IFRIC concluded, as part of its

redeliberations, that the restriction was appropriate because the foreign exchange differences between the parent's functional currency and both the hedging instrument and the functional currency of the net investment would automatically be included in the group's foreign currency translation reserve as part of the consolidation process.

BC24B After IFRIC 16 was issued, it was brought to the attention of the International Accounting Standards Board that this conclusion was not correct. Without hedge accounting, part of the foreign exchange difference arising from the hedging instrument would be included in consolidated profit or loss. Therefore, in *Improvements to IFRSs* issued in April 2009, the Board amended paragraph 14 of IFRIC 16 to remove the restriction on the entity that can hold hedging instruments and deleted paragraph BC24.

BC24C Some respondents to the exposure draft *Post-implementation Revisions to IFRIC Interpretations* (ED/2009/1) agreed that a parent entity should be able to use a derivative held by the foreign operation being hedged as a hedge of the net investment in that foreign operation. However, those respondents recommended that the amendment should apply only to derivative instruments held by the foreign operation being hedged. They asserted that a non-derivative financial instrument would be an effective hedge of the net investment only if it were issued by the foreign operation in its own functional currency and this would have no foreign currency impact on the profit or loss of the consolidated group. Consequently, they thought that the rationale described in paragraph BC24B to support the amendment did not apply to non-derivative instruments.

BC24D In its redeliberations, the Board confirmed its previous decision that the amendment should not be restricted to derivative instruments. The Board noted that paragraphs AG13–AG15 of IFRIC 16 illustrate that a non-derivative instrument held by the foreign operation does not need to be considered to be part of the parent's net investment. As

a result, even if it is denominated in the foreign operation's functional currency a non-derivative instrument could still affect the profit or loss of the consolidated group. Consequently, although it could be argued that the amendment was not required to permit non-derivative instruments to be designated as hedges, the Board decided that the proposal should not be changed.

Effective date of amended paragraph 14

BC40A The Board amended paragraph 14 in April 2009. In ED/2009/01 the Board proposed that the amendment should be effective for annual periods beginning on or after 1 October 2008, at the same time as IFRIC 16. Respondents to the exposure draft were concerned that permitting application before the amendment was issued might imply that an entity could designate hedge relationships retrospectively, contrary to the requirements of IAS 39. Consequently, the Board decided that an entity should apply the amendment to paragraph 14 made in April 2009 for annual periods beginning on or after 1 July 2009. The Board also decided to permit early application but noted that early application is possible only if the designation, documentation and effectiveness requirements of paragraph 88 of IAS 39 and of IFRIC 16 are satisfied at the application date.

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