



EUROPEAN COMMISSION

Internal Market and Services DG

FREE MOVEMENT OF CAPITAL, COMPANY LAW AND CORPORATE GOVERNANCE

**Accounting**

Brussels, 17 February 2009

MARKT F3 D(2009)

**Endorsement of the Amendments to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments: Disclosures* "Reclassification of Financial Assets – Effective Date and Transition"**

**Introduction, background and conclusions**

Attachment 1: Effect study prepared by the European Financial Reporting Advisory Group (EFRAG)

Attachment 2: Endorsement advice prepared by EFRAG

## **1. EFFECT STUDY**

The European Commission has agreed with the European Parliament that Effect Studies should be prepared for new accounting standards and interpretations up for endorsement in the European Union (EU). The Commission Services together with the European Financial Reporting Advisory Group (EFRAG) prepare these studies containing description of the accounting issues involved, results from stakeholder consultations as well as analysis of effects of using the new accounting rules in the EU.

EFRAG has prepared an Effect Study for the Amendments to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments: Disclosures* "Reclassification of Financial Assets – Effective Date and Transition" (attached). As the EFRAG Effect Study refers to the Endorsement Advice, we also included it in attachments.

This cover note contains background information, comments and a conclusion by the Commission Services.

## **2. BACKGROUND ON THE AMENDMENTS TO IAS 39 AND IFRS 7**

### *Explanation of the issue*

The IASB issued on 13 October 2008 an urgent Amendment to IAS 39 and IFRS 7. The Amendment was adopted by the European Union on 15 October 2008. This Amendment allows entities in rare circumstances to reclassify non-derivative financial assets out of the held-for-trading category and the available-for-sale category. The reclassification should be made at fair value on the date of reclassification, but backdating to 1 July 2008 could be done before 1 November 2008.

The IASB developed this Amendment without following their normal due process and issued the final amendment without any prior public consultation. One of the unintended consequences was that there was some ambiguity in the wording in relation to the effective date and the transitional periods.

To avoid this ambiguity, the IASB clarified its intentions on 24 October 2008 in the October IASB Update. On 27 November 2008, the IASB issued the amendment to formally incorporate the clarification into IFRS.

### *How was the issue dealt by the amendment of October?*

The IASB intentions on the October Amendment had been to allow reclassifications to be backdated as long as a) the reclassification is made before 1 November 2008 and b) the reclassification is not backdated to a date before 1 July 2008. In other cases (when the reclassification is made after 1 November 2008) the financial instruments should be transferred at the fair value of the date when the reclassification is made.

However, the Amendment was not completely clear on this aspect. The Amendment stated that "any reclassification of a financial asset made in periods beginning on or after 1 November 2008 shall take effect only from the date when the reclassification is made". This wording could have been interpreted to mean that reclassifications made in periods starting on or before 31 October 2008 can be backdated to 1 July 2008.

*How does the amendment of November clarify the issue?*

The November Amendment clarifies the effective date and the transition requirements to the Amendment to IAS 39 and IFRS 7 issued on 13 October 2008.

This Amendment clarifies the intention of the IASB, any reclassification made after 1 November 2008 shall take effect only from the date when the reclassification is made.

*Date of application (EU legal endorsement)*

The IASB correction of November is to be applied retroactively as from 13 October. Retroactive legislation is however unusual in EU legislation and the Commission will propose that EU endorsement of the amendments to IAS 39 and IFRS 7 should be applied as from the date of its entering into force, i.e. approximately 1 July 2009. Financial statements already prepared and presented on the basis of the October Amendment do not need to be retroactively amended.

Companies as from the entry into force of the Regulation will not be able to reclassify back to 1 July 2008.

### **3. EFFECT ANALYSIS**

*Main points identified in the EFRAG Effect Analysis*

EFRAG has analysed together the Amendment to the Effective Date with the initial Amendment to IAS 39 and IFRS 7. On balance, EFRAG believes that the benefits that would arise from the October Amendment and the November Amendment were likely to exceed the costs involved.

#### Costs and benefits for preparers

EFRAG's analysis concluded that the reclassification Amendment will involve some costs for preparers making the reclassifications although, as the reclassifications are optional, those costs are voluntary. EFRAG believes that preparers will implement the October Amendment only if they believe that the benefits of the implementation from them will exceed the costs involved.

#### Costs and benefits for users

According to EFRAG, users are divided between those that believe that the reclassifications (October Amendment) will make financial statements more relevant and understandable and those that will wish to eliminate the effect of the reclassification. However, for the latter users the additional disclosures required by the October Amendment will help to minimise the additional analysis costs.

### **4. OVERALL COST-BENEFIT CONSIDERATIONS AND COMMISSION SERVICES CONCLUSIONS**

On the basis of EFRAG's Effect Study, the Commission Services have considered the main costs and benefits of endorsing the Amendment to IAS 39 and IFRS 7 and concluded that the benefits of adopting the Amendment outweigh the costs incurred.

The Commission Services believe that the Amendment to IAS 39 and IFRS 7 will have positive cost-benefits effects and that it should therefore be endorsed in the EU without delay.

## **Attachment 1**

Effect study prepared by the European Financial Reporting Advisory Group  
(EFRAG)

## **EFRAG'S EVALUATION OF THE COSTS AND BENEFITS OF THE AMENDMENT TO IAS 39 and IFRS 7 "RECLASSIFICATIONS OF FINANCIAL ASSETS – EFFECTIVE DATE AND TRANSITION"**

### **INTRODUCTION**

- 1 Following discussions in 2007 between the various parties involved in the EU endorsement process, it was decided that more extensive information than hitherto should to be gathered on the costs and benefits of all new or revised Standards and Interpretations as part of the endorsement process. It has further been agreed that EFRAG will gather that information in the case of the Amendment to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments: Disclosures* "Reclassification of Financial Assets – Effective Date and Transition" (the Amendment).
- 2 EFRAG first considered how extensive the work would need to be. For some Standards or Interpretations, it might be necessary to carry out some fairly extensive work in order to understand fully the cost and benefit implications of the Standard or Interpretation being assessed. However, in the case of the Amendment, EFRAG's view is that the cost and benefit implications can be assessed by carrying out a more modest amount of work. (The results of the consultations EFRAG has carried out seem to confirm this). Therefore, as explained more fully in the main sections of the report, the approach EFRAG has adopted has been to carry out detailed initial assessments of the likely costs and benefits of implementing the Amendment in the EU, to consult on the results of those initial assessments, and to finalise those assessments in the light of the comments and information received.

### **EFRAG's endorsement advice**

- 3 EFRAG already carries out a technical assessment of all new and revised Standards and Interpretations issued by the IASB and IFRIC against the so-called endorsement criteria and provides the results of those technical assessments to the European Commission in the form of recommendations as to whether or not the Standard or Interpretation assessed should be endorsed for use in the EU. As part of those technical assessments, EFRAG gives consideration to the costs and benefits that would arise from implementing the new or revised Standard or Interpretation in the EU. EFRAG has therefore taken the conclusion at the end of this report into account in finalising its endorsement advice.

### **A SUMMARY OF THE AMENDMENT**

- 4 This Amendment clarifies the effective date and transition requirements of the amendment to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments: Disclosures* "Reclassification of Financial Assets"

*EFRAG's Effects Study Report on the Amendment to IAS 39 and IFRS 7  
Reclassifications of Financial Assets: Effective Date and Transition*

issued on 13 October 2008 (the October amendment). EFRAG recommended the October amendment for endorsement in the EU, and it has since been endorsed.

- 5 The October amendment permitted entities in certain circumstances to reclassify non-derivative financial assets out of the held-for-trading category and the available-for-sale category at fair value on the date of reclassification. Such reclassifications are to be carried out on a real-time basis (ie at the current date), except that the amendment allows some backdating to 1 July 2008 as part of the transitional arrangements. The Amendment clarifies the degree of backdating to be allowed.
- 6 The IASB's intention had been to allow reclassifications to be backdated as long as (a) the reclassification is made before 1 November 2008 and (b) the reclassification is not backdated to a date before 1 July 2008.
- 7 However, shortly after the October 2008 amendment was issued it became apparent that the effective date and the transitional requirements of the October amendment had been ambiguously drafted and as a result did not fully reflect the IASB's intentions. That is because the October amendment stated that "any reclassification of a financial asset made in periods beginning on or after 1 November 2008 shall take effect only from the date when the reclassification is made" and this wording has been interpreted by some to mean that reclassifications made in periods starting on or before 31 October 2008 can be backdated to 1 July 2008.
- 8 On 24 October 2008 the IASB clarified its intentions with regard to the effective date and the transitional requirements in the October 2008 issue of the IASB Update, an official IASB report on its deliberations and decisions taken during the IASB public meetings. The Amendment, which was issued on 27 November 2008, formally incorporates that clarification into IFRS.

## **EFRAG'S INITIAL ANALYSIS OF THE COSTS AND BENEFITS OF THE CLARIFICATION**

- 9 In carrying out its initial assessment, EFRAG took the view that it was not appropriate to evaluate the Amendment on a standalone basis; rather, it should be evaluated together with the October amendment. The October amendment was issued following an urgent request from Europe. Indeed, because of the urgency that had been attached to the request made to the IASB, the IASB had no choice if the request was to be met but to put aside its normal due process and issue a final amendment without any prior public consultation. This action was without precedent. The IASB has a due process for very good reasons. One of those reasons is that it makes it less likely that the IASB will include ambiguous wording in its final documents. Requesting urgent action from the IASB and therefore asking it to put aside its due process meant accepting the risk that drafting ambiguities might arise in the resulting standard and, if any did arise, that it should be acceptable for the IASB to clarify the drafting.
- 10 EFRAG has therefore considered to what extent its assessment would have been different had this Amendment been part of the October amendment. EFRAG's tentative assessment was that its assessment would not have been different. Indeed, the effective date and transition arrangements in the October amendment were described to EFRAG at the meeting at which the October amendment was evaluated in terms that were consistent with this Amendment. The results of the

initial assessment can be summarised as follows. This Amendment considered together with the October amendment:

- (a) will involve preparers in some additional costs to make the reclassifications, although reclassification is optional so those costs are taken on voluntarily;
  - (b) will involve users in some insignificant additional analysis costs; and
  - (c) will involve benefits that are likely to exceed those costs.
- 11 EFRAG published its initial assessment of the costs and benefits of implementing this Amendment and the October amendment in the EU and supporting analysis on 8 December 2008 and invited comment on it until 8 January 2009. In response, all but one of the letters commenting on EFRAG's initial assessment agreed with it. The other letter stated that their experience was that costs involved for preparers in implementing the October amendment are not insignificant.

## **EFRAG's FINAL ANALYSIS OF THE COSTS AND BENEFITS OF THE AMENDMENT**

- 12 Based on its initial analysis and comment letters received in response to that analysis, EFRAG's final analysis of the costs and benefits of the Amendment is presented in the paragraphs below.

### **Costs and benefits for preparers**

- 13 When EFRAG assessed the October amendment, it noted that there would be costs involved for preparers in making the reclassifications although, as reclassification is optional, those costs are voluntarily incurred. Those costs can be significant in some cases. However, since the implementation of the October amendment is voluntary, EFRAG expects that preparers will implement the October amendment only if they believe that the benefits of the implementation for them will exceed the costs involved. EFRAG believes that the Amendment does not change this assessment in any way.

#### Possible implications for those who had been interpreting the effective date and transitional requirements of the October amendment differently

- 14 One obvious implication of the Amendment is that it will not be possible to make reclassifications in the future and backdate them, perhaps to 1 July 2008. This will disrupt some entities' plans. Indeed, some entities might have deliberately chosen not to rush their reclassifications so that they were made before 1 November 2008 because they thought they had plenty of time to do them and still backdate them. EFRAG notes however that the IASB clarified its intentions as early as 24 October when it issued IASB Update.
- 15 Another implication of the Amendment is that any reclassification made since 31 October 2008 that has been backdated will need to be reversed and replaced by a current date reclassification. However, in EFRAG's view, the IASB's decision to issue a clarification of the problematical wording on 24 October 2008, and its decision to issue this Amendment as soon as possible thereafter, has minimised this need.

**Costs and benefits for users**

- 16 When EFRAG assessed the October amendment, it also noted that reclassifications will make the financial statements more complex in some regards.
- (a) Some users believe reclassifications will make financial statements more relevant and understandable, and for those users it is probably the case that the benefits arising from increased relevance and understandability offset the increased complexity.
  - (b) Some users however do not believe the October amendment will make the financial statements more relevant; many of these users will wish to eliminate the effect of reclassifications made in accordance with the October amendment, thus incurring additional costs in performing their analysis. EFRAG notes however that the additional disclosures that the October amendment requires entities to provide if they reclassify certain instruments should help to minimise those additional analysis costs for these users.

EFRAG believes that the Amendment does not change this assessment.

**Overall assessment**

- 17 On balance, EFRAG believes that the benefits that would arise from the October amendment and this Amendment were likely to exceed costs involved.

Stig Enevoldsen  
**EFRAG, Chairman**  
15 January 2009

## **Attachment 2**

Endorsement advice prepared by EFRAG

Jörgen Holmquist  
Director General  
European Commission  
Directorate General for the Internal Market  
1049 Brussels

16 January 2009

Dear Mr Holmquist

**Adoption of the Amendment to IAS 39 and IFRS 7 “Reclassification of Financial Assets – Effective Date and Transition”**

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards we are pleased to provide our opinion on the adoption of the Amendment to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments: Disclosures* “Reclassification of Financial Assets – Effective Date and Transition” (the Amendment) which was issued by the IASB in November 2008.

This Amendment clarifies the effective date and transition requirements of the amendment to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments: Disclosures* “Reclassification of Financial Assets” issued on 13 October 2008 (the October amendment).

The October amendment permits entities in certain circumstances to reclassify non-derivative financial assets out of the held-for-trading category and the available-for-sale category at fair value on the date of reclassification. Such reclassifications are to be carried out on a real-time basis (ie at the current date), except that the amendment allows some backdating. This Amendment clarifies that in line with the IASB’s original intention reclassifications can be backdated as long as (a) the reclassification is made before 1 November 2008 and (b) the reclassification is not backdated to a date before 1 July 2008.

EFRAG has carried out an evaluation of this Amendment together with the October amendment. As part of that process, EFRAG issued an initial evaluation for public comment and, when finalising its advice and the content of this letter, it took the comments received in response into account. EFRAG’s evaluation is based on input from standard setters, market participants and other interested parties, and its discussions of technical matters are open to the public.

EFRAG supports the Amendment and has concluded (having considered it together with the October amendment) that it meets the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards in that:

*EFRAG's endorsement advice on the Amendment to IAS 39 and IFRS 7 Reclassifications of Financial Assets: Effective Date and Transition*

- it is not contrary to the 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and
- it meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

For the reasons given above, EFRAG believes that it is in the European interest to adopt the Amendment and, accordingly, EFRAG recommends its adoption. EFRAG's reasoning is explained in the attached 'Appendix - Basis for Conclusions'.

On behalf of the members of EFRAG, I should be happy to discuss our advice with you, other officials of the EU Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely

Stig Enevoldsen  
**EFRAG, Chairman**

## **APPENDIX BASIS FOR CONCLUSIONS**

*This appendix sets out the basis for the conclusions reached, and for the recommendation made, by EFRAG on the Amendment to IAS 39 and IFRS 7.*

*In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG's capacity as a contributor to the IASB's due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as adviser to the European Commission on endorsement of the final IFRS or Interpretation on the issue.*

*In the latter capacity, EFRAG's role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the European endorsement criteria, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG's thinking may evolve.*

### **Introduction**

- 1 On 13 October 2008 the IASB issued the amendment to IAS 39 and IFRS 7 *Reclassification of Financial Assets* (the October amendment). On 14 October EFRAG evaluated the October amendment, concluded that it met the EU endorsement criteria, and issued an endorsement advice letter to that effect. The amendment was subsequently endorsed.
- 2 This Amendment clarifies the effective date and transitional requirements of the October amendment.
- 3 The October amendment was issued following an urgent request from Europe. Indeed, because of the urgency that had been attached to the request made to the IASB, the IASB had no choice if the request was to be met but to put aside its normal due process and issue a final amendment without any prior public consultation. This action was without precedent. The IASB has a due process for very good reasons. One of those reasons is that it makes it less likely that the IASB will include ambiguous wording in its final documents. Requesting urgent action from the IASB and therefore asking it to put aside its due process meant accepting the risk that drafting ambiguities might arise in the resulting standard and, if any did arise, that it should be acceptable for the IASB to clarify the drafting.
- 4 Bearing that in mind, EFRAG believes that it should not evaluate this Amendment on a standalone basis against the EU endorsement criteria. Rather, EFRAG believes it should evaluate the October amendment and the Amendment together. In other words, would EFRAG's advice on the October amendment have been different had the Amendment been part of it?
- 5 Having formed a tentative view on the above issue and prepared a draft assessment, EFRAG issued that draft assessment on 8 December 2008 and asked for comments on it by 8 January 2009. EFRAG has considered all the comments received in response, and the main comments received are dealt with in the discussion in this appendix.

## **Conclusion**

- 6 EFRAG's view is that its advice would not have been different had the October amendment included the Amendment. That is because EFRAG's assessment is that the October amendment plus the Amendment meet the criteria for EU endorsement; in other words, together they:
- (a) are not contrary to the 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and
  - (b) meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.
- 7 EFRAG has also concluded that it would be in the European interest to adopt the Amendment.

## **Rationale**

- 8 The general principle in the October amendment is that certain reclassifications out of held-for-trading and available-for-sale should be permitted, as long as they are made on a real-time (ie current day basis), and disclosures about the reclassifications made are provided. When EFRAG assessed the October amendment, it took the view that the application of this principle would result in information that meets the EU endorsement criteria. The one concern that existed related to the optionality that the amendment involves, although EFRAG concluded that this would not give rise to significant comparability concerns bearing in mind the flexibility that already exists in the standard.
- 9 The IASB decided it was necessary to allow a degree of backdating of reclassifications to give entities time to carry out the calculations needed to implement the October amendment appropriately. EFRAG took the view this was a good piece of pragmatic standard-setting. Backdating always brings with it concerns about comparability and understandability, but it can be a cost worth paying for a bigger benefit—and it was EFRAG's view that that was the case in this instance.
- 10 The effective date and transition provisions of the October amendment were not debated at any length when EFRAG was developing its endorsement advice on that amendment. However, a number of EFRAG members and staff were present when the IASB debated the amendment and/or had discussed the amendment with IASB Board members and/or staff and as a result understood what the intentions of the IASB were. Those intentions were communicated to EFRAG at the meeting at which EFRAG developed its advice, but were not a major factor in EFRAG's deliberations.