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Sir David Tweedie
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Recent discussions on hedge accounting

Dear David

The AASB has concerns about the discussion on hedge accounting on 12-15 April 2011 IASB/FASB meeting. At that meeting, the IASB reconsidered whether equity investments at fair value through other comprehensive income (FVTOCI) should be eligible hedged items (IASB Agenda Paper 8). The IASB tentatively decided to allow equity instruments at FVTOCI to be designated as eligible hedged items, but that it would not extend the eligibility to other items measured through other comprehensive income (OCI). The AASB supports this decision.

However, we observed that it was a very close vote and in the discussion that led to the decision, some IASB members sought to have the definition of non-trading equity investments and the types of investments that are able to be classified and measured at FVTOCI redeliberated. Those members indicated a preference for narrowing the presentation exception to be investments that are held for strategic purposes (which is discussed in paragraph BC5.25(c) of IFRS 9 *Financial Instruments*).

As noted in its response to IASB ED/2009/7 *Financial Instruments: Classification and Measurement*, the AASB was not opposed to allowing the presentation of dividends in the income statement and fair value movements on long-term equity investments in OCI where those investments are held to generate yield for unit holders as part of the entity's normal business operations.

At its meeting on 15-16 September 2009, the IASB decided to allow the recognition of dividends in profit or loss for equity investments classified and measured at FVTOCI, and noted that it was not possible to come up with a clear and robust principle for the FVTOCI presentation exception and therefore confirmed that "...the FVTOCI presentation exception:

- (a) is available for any equity investment that is not held-for-trading; and
- (b) is made at initial recognition and is irrevocable." [IASB Staff paper; Agenda Paper 6; 15-16 October 2009; Classification and measurement: Instruments measured at fair value through other comprehensive income]

Based on this, Australian Listed Investment Companies classify their long-term investments at FVTOCI under IFRS 9, and this reflects their business philosophy in which they hold investments for dividend income and treat valuation adjustments as if they were changes in the capital of the entity. Distributions are based on the former and not the latter. These companies are quite old and can be characterised as conservative, non-trading investors with a philosophy that investments are made for their returns. They mark all their investments to fair value and previously transferred changes in value between retained earnings and a separate reserve, whilst trying to explain their income statement to users. If the IASB were to vacillate on the presentation exception, these entities would again not be able to easily reflect their approach.

These entities were earlier adopters of IFRS 9 and seem to have done so in good faith. Though the IASB may have seen merit in discussions for treating strategic investments in a particular way, it did not carry that thinking into the standard and seems not to have thought of other situations in which the same approach would be suitable.

The AASB continues to be concerned that the underlying problem in IASB deliberations is the lack of a coherent theory for other comprehensive income. Some members see it as a necessary evil while others see it as a legitimate way of distinguishing different types of income. The AASB supports the latter view. We do not think constituents should suffer because of this problem being unresolved or because of fears of abuse in other circumstances.

Yours sincerely



Kevin M Stevenson
Chairman and CEO

Cc Warren McGregor