

List of submissions to ED 189 *Financial Instruments: Amortised Cost and Impairment*

- 1 Australasian Council of Auditors-General (ACAG)
- 2 Heads of Treasuries Accounting and Reporting Advisory Committee (HoTAaRAC)
- 3 Grant Thornton
- 4 CPA Australia, the Institute of Chartered Accountants and the National Institute of Accountants (the Joint Accounting Bodies)

17 May 2010

Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
Collins St West
MELBOURNE VIC 8007

Dear Mr Stevenson

**EXPOSURE DRAFT 189 FINANCIAL INSTRUMENTS:
AMORTISED COST AND IMPAIRMENT**

Attached is the Australasian Council of Auditors-General (ACAG) response to the Exposure Draft referred to above. The response includes replies to the additional questions from the Australian Accounting Standards Board Roundtables on ED 189 held in Sydney and Melbourne (questions indicated with asterisks ** and boxed).

The views expressed in this submission represent those of all Australian members of ACAG.

The opportunity to comment is appreciated and I trust you will find the attached comments useful.

Yours sincerely



Simon O'Neill
Chairman
ACAG Financial Reporting and Auditing Committee



17 May 2010

Sir David Tweedie
Chairman
International Accounting Standards Board
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United Kingdom

Dear Sir David

**EXPOSURE DRAFT ED/2009/12 FINANCIAL INSTRUMENTS:
AMORTISED COST AND IMPAIRMENT**

Attached is the Australasian Council of Auditors-General (ACAG) response to the Exposure Draft referred to above. The response includes replies to the additional questions from the AASB Roundtables on ED 189 held in Sydney and Melbourne (questions indicated with asterisks ** and boxed).

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Yours sincerely

Simon O'Neill
Chairman
ACAG Financial Reporting and Auditing Committee

cc: Mr Kevin Stevenson, Chairman, Australian Accounting Standards Board

Section A: Questions from the IASB ED *Financial Instruments: Amortised Cost and Impairment* and additional questions from the AASB.

Question 1

Is the description of the objective of amortised cost measurement in the exposure draft clear? If not, how would you describe the objective and why?

Yes, the description of the objective is clear. Comments regarding perceived difficulties in auditing this mixed model of amortised cost measurement are discussed below.

Question 2

Do you believe that the objective of amortised cost set out in the exposure draft is appropriate for that measurement category? If not, why? What objective would you propose and why?

Yes, the objective is appropriate for that measurement category. Comments regarding perceived difficulties in auditing this mixed model of amortised cost measurement are discussed below.

Question 3

Do you agree with the way that the exposure draft is drafted, which emphasises measurement principles accompanied by application guidance but which does not include implementation guidance or illustrative examples? If not, why? How would you prefer the standard to be drafted instead, and why?

The principles-based approach accompanied by application guidance is useful, however, implementation guidance and illustrative examples have historically proven to be beneficial in interpreting the requirements of a standard, especially in areas that necessitate significant management assumptions and judgement. Given the potential challenges in auditing an entity's compliance with various aspects of this standard (especially in regards to auditing the estimates of expected cash flows, including the "probability-weighted possible outcomes" and expected loss calculations, etc), our preference would be for this standard to include implementation guidance with accompanying illustrative examples.

Question 4

(a) Do you agree with the measurement principles set out in the exposure draft? If not, which of the measurement principles do you disagree with and why?

We agree with the measurement principles outlined in the exposure draft, however from an audit perspective, we foresee difficulties in auditing the 'probability-weighted possible outcomes' (paragraph 8) and the expected credit losses encapsulated within the calculation of 'expected cash flows over the remaining life of the financial instrument' (paragraph 6(a)). With this move from the incurred loss model to the expected loss approach (with earlier recognition of credit losses), there is also potential for management to use both of these areas to engage in 'earnings management', and we would support the provision of implementation guidance for this standard, particularly in respect of these two areas.

For financial instruments that have a remaining life longer than the observable market the requirement to forecast credit losses, where material, may result in the issue of an emphasis of matter opinion by the auditor on the basis of the inherent uncertainty of the forecast. It is our view that the approach taken in AASB 136 to limit the estimate of cash flows to 5 years is a more pragmatic approach to forecasting.

(b) Are there any other measurement principles that should be added? If so, what are they and why should they be added?

There need to be measurement principles (or at least some implementation guidance) for the allowance account. The measurement principles enunciated in paragraphs 6-10 do not directly address the credit impact on the amounts and timing of cash flows when clearly this is the key current input regarding the cashflow estimates. The presentation and disclosure paragraph 13(b) specifically refers to the presentation of “expected credit losses allocated to the period”, however in paragraph 8, for example, the only reference to credit is inferred from the following statement “The estimates for the cash flow inputs are expected values. Hence, estimates of the amounts and timing of cash flows are the probability-weighted possible outcomes.”

It is assumed that the estimation of the impact of credit on cashflows is undertaken utilising a probability-weighted outcomes process, however there appears to be little guidance on the appropriate approach to undertake this process. Application guidance paragraphs B3-B10 outline points to consider in estimating the credit impact on cashflows and avenues where information can be gained. The area of audit concern is the lack of guidance on the minimum principles expected to be applied in deriving the impact of credit on cashflows. For example, depending on the level of sophistication, entities will apply different forecasting approaches, however in practice each will attempt to access current credit information and will assess the effectiveness of their information sources. Some can afford to access current information, others can not. Some will engage specialists to review the assessment process whereas others will only apply their own judgement.

Paragraphs B8 and B9 allude to the principle of back-testing to determine whether the use of historical credit loss rates reflects relevant observable data. Such a principle is supported for all measures of credit risk and would provide greater guidance for entities (and their auditors) in providing the estimates of the impact on cashflows.

***** Do participants agree with the measurement model proposed in the IASB ED, which incorporates the accounting for impairment based on the assessment of expected cash flows? For example:***

(a) Do participants believe that paragraph B8:

(i) is helpful when making the assessment of changes in expected cash flows; and

The rationale for paragraph B8 makes sense but will be challenging to implement in practice. Given the move away from the incurred loss model, we believe implementation guidance is required to help ensure entities (and their auditors) clearly understand the requirements of this aspect of the standard.

(ii) would change current practice when assessing for impairment?

We expect that the move from the incurred loss model to the expected loss model will result in a change in current practice. The incurred loss model has a historical focus (collectability based on history), with losses expected as a result of future events, no matter how likely, not being recognised. Again we believe implementation guidance is required to help ensure entities (and their auditors) clearly understand the practicalities of calculating expected losses under this standard.

(b) What are the participants' views on recognising gains from favourable changes in expectations, or from reversals of impairment losses, under the proposed measurement model?

Accounting standards have traditionally tended to adopt a conservative recognition approach (lower 'hurdles' for recognising expenses than for recognising revenue). Other accounting standards tend to deal with less subjective measurements than credit risk. Accordingly, to allay concerns over the potential for 'earnings management', ED 189 should be more prescriptive around the principles to apply when estimating impairment losses and likewise reversals, and supplement this with illustrative guidance.

(c) How difficult do you think it will be to use expected values (i.e. probability-weighted numbers) in determining the impairment amount?

In practice it could be quite difficult to use expected values in determining the impairment amounts. From a conceptual viewpoint the level of rigour applied by entities around this process varies significantly by entity size and industry. In this respect we concur with the alternative views of Robert P Garnett and James J Leisenring in paragraph AV4 ('Alternative view on exposure draft' section), and in particular their expected cash flow assertion comment that "the loss expectations of management cannot be audited". Hence the expected cash flow cannot be audited.

Principles are therefore required to ensure that all expected value estimates meet the criteria promulgated in the accounting framework.

(d) Would it be appropriate to use 'historical' effective interest rates (determined by iteration at inception of a financial asset) as opposed to current discount rates (consistent with IAS 36) at least when cash flows are reassessed, in determining the carrying amount for financial instruments measured at amortised cost?

Given the intent of this standard to effectively shield these financial instruments measured at amortised cost from full fair value measurement (arguably to the potential detriment of the comparability and relevance of financial statements), it would seem appropriate to use 'historical' effective interest rates. The consequent difficulty will be in explaining to users what the amortised cost amounts disclosed in the financial statements actually purport to represent.

Question 5

Is the description of the objective of presentation and disclosure in relation to financial instruments measured at amortised cost in the exposure draft clear? If not, how would you describe the objective and why?

The description of the objective is clear, however:

- It could make specific mention of the timing of the principal cashflows (when disclosing origination/maturity information required by paragraph 22). For example: 'An entity shall present and disclose information that enables users of the financial statements to evaluate the financial effect of interest revenue and expense, the timing of principal cashflows, and the quality of financial assets including credit risk .' (Suggestion only)

- We would support the proposal in the box at the bottom of page 16, to treat the presentation and disclosure requirements as amendments of AASB 101 *Presentation of Financial Statements* and AASB 7 *Financial Instruments: Disclosures*, respectively (particularly in terms of integrating the credit and liquidity risk disclosures).

(a) Do you believe that the objective of presentation and disclosure in relation to financial instruments measured at amortised cost set out in the exposure draft is appropriate? If not, why? What objective would you propose and why?

Given the objective of this ED, yes the objective of presentation and disclosure is appropriate, however, could be enhanced - refer (a) above.

Question 6

Do you agree with the proposed presentation requirements? If not, why? What presentation would you prefer instead and why?

The proposed presentation requirements are somewhat cumbersome (especially when presented in the statement of comprehensive income along with other interest revenue from financial assets held at fair value), however, are considered necessary given the intent of this ED.

Question 7

(a) Do you agree with the proposed disclosure requirements? If not, what disclosure requirement do you disagree with and why?

As noted below, some of the proposed disclosure requirements may prove overly onerous for the non-banking sector, and the AASB/IASB may wish to consider a reduced level of disclosures for these other sectors.

Regarding paragraph 17, the practicality of actually *identifying* the inputs in determining expected credit losses is difficult and where material may impact the audit opinion where there is inherent uncertainty. In this respect we concur with the alternative views of Robert P Garnett and James J Leisenring in paragraph AV4 ('Alternative view on exposure draft' section) regarding their assertion that "the loss expectations of management cannot be audited". We would support the inclusion of particular implementation guidance on this aspect. From past experience in auditing areas involving the application of significant management assumptions and judgment, we expect some entities to tend towards standard pro-forma disclosures for an area such as this.

Regarding paragraphs 19 and 22, this information would be interesting and useful to users of financial statements, however could prove quite voluminous (where disclosed by class by year of origination and maturity per paragraph 22) and cumbersome to financial statement preparers, auditors and users alike, and may necessitate the use of appropriate timebands to display the required information.

The inclusion of stress testing information is supported, however it may well be very difficult (at least initially, until these disclosures 'evolve' over time), to compare the disclosures between entities, given the very different approaches to, purposes of, and varying sophistication levels of, stress testing performed by different entities (including tests performed over not just financial instruments held at amortised cost but also those held at fair value). We seek clarification as to whether it is only credit risk stress testing that would need to be disclosed? In any case, entities will need to very clearly disclose the nature, purpose, timing and extent of the stress testing performed, as well as the inherent limitations of any stress tests.

Another important consideration here is the potential impact of these disclosures on the audit opinion – will the auditor need to audit the stress test results if they are disclosed in the notes to the financial statements? Will the auditor effectively be certifying that the entity can withstand the stress scenario/s?

(b) What other disclosures would you prefer (whether in addition to or instead of the proposed disclosures) and why?

As part of disclosures made under paragraph 17, the disclosure of principles/approaches adopted by entities such as “backtesting credit estimation methodologies and performance attribution” would provide users with greater assurance that credit assessments are reliable in comparison with the more general pro-forma (‘boiler plate’) disclosures such as vague references to the use of inputs such as information from ratings agencies, etc.

Question 8

Would a mandatory effective date of about three years after the date of issue of the IRS allow sufficient lead-time for implementing the proposed requirements? If not, what would be an appropriate lead-time and why?

From an audit perspective, the lead time appears reasonable.

Question 9

(a) Do you agree with the proposed transition requirements? If not, why? What transition approach would you propose instead and why?

Yes.

(b) Would you prefer the alternative transition approach (described above in the summary of the transition requirements)? If so, why?

No strong preference – entities should still have the relevant information to prepare restated comparative information (especially given the three year lead time for implementation).

(c) Do you agree that comparative information should be restated to reflect the proposed requirements? If not, what would you prefer instead and why? If you believe that the requirement to restate comparative information would affect the lead-time (see Question 8) please describe why and to what extent.

Yes, the requirement to present restated comparative information appears reasonable given the length of the lead-time provided.

Question 10

Do you agree with the proposed disclosure requirements in relation to transition? If not, what would you propose instead and why?

The proposed disclosure requirements in relation to transition appear reasonable.

Question 11

Do you agree that the proposed guidance on practical expedients is appropriate? If not, why? What would you propose instead and why?

Yes these are appropriate as they are principles based, and should assist those non-bank entities (with less sophisticated systems than big banks) in applying this standard.

Question 12

Do you believe additional guidance on practical expedients should be provided? If so, what guidance would you propose and why? How closely do you think any additional practical expedients would approximate the outcome that would result from the proposed requirements and what is the basis for your assessment?

Yes, additional guidance on practical expedients should be provided and would be useful, particularly in regards to credit estimation techniques.

**** Is there a need for more consideration to be given to financial assets that are not loan receivables? For instance, participants should consider how the proposed measurement model would apply to, for example medium to longer term trade receivables.**

Clearly the main focus of this ED is on financial institutions and the AASB should ensure that the principles are equally applicable to non loan receivables and other receivables held by other sectors. Some additional guidance may be required.

Section B: Questions Specifically Related to Public Sector/Not-For-Profit Entities

**** Do you think there are any proposals in the ED that are inappropriate for public sector entities or not-for-profit entities in particular? If so, what are those proposals and why do you regard them as inappropriate?**

Some of the qualitative and quantitative disclosure requirements may prove particularly onerous for public sector entities to comply with (e.g. the disclosures by origination in paragraphs 19 and 22), and we would welcome any guidance on the extent of disclosures actually required for non-bank entities or non-central borrowing authorities.

The basic calculation examples provided on the IASB website are useful and we believe entities would find the provision of additional worked examples beneficial in understanding the calculation requirements of this ED.

In relation to the application of ED 189 to the public sector, there is one specific area in which we would welcome additional guidance – loans at no or low interest. (We note the recent AASB confirmation of its view that AASB 136 *Impairment of Assets* (rather than AASB 139 *Financial Instruments: Recognition and Measurement*) applies to the impairment of statutory receivables because of the non-contractual nature of such receivables, and so this area has not been re-considered here.)

Loans at no or low interest

Loan arrangements in government are sometimes used in lieu of grants – The terms and conditions of these loans typically include low or no interest payments. These loans, according to the accounting policies of both the borrower and lender, are often fair valued at inception based upon a market rate for similar loans. We believe that more specific guidance on these arrangements for not-for-profit entities (who don't apply AASB 120 *Accounting for Government Grants*) is required in (or issued in conjunction with) ED 189 – specifically:

- How amortised cost would apply to the loan?
- How credit is assessed for research and development (R&D) projects where collectability is contingent on the development of a commercially successful product. (E.g. how does the entity providing the loan assess the viability of the project?). Similar questions arise for green loans, loans to non-government organisations (NGOs), etc.

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Dear Mr Stevenson

AASB EXPOSURE DRAFT 189 FINANCIAL INSTRUMENTS: AMORTISED COST AND IMPAIRMENT

The Heads of Treasuries Accounting and Reporting Advisory Committee welcomes the opportunity to provide comments to the Australian Accounting Standards Board on Exposure Draft 189 *Financial Instruments: Amortised Cost and Impairment*.

Comments by HoTARAC on questions from the Exposure Draft are in Attachment 1.

HoTARAC commends the IASB on its endeavours to reduce the complexity of accounting for financial instruments and address some of the issues raised during the Global Financial Crisis. Overall, however, HoTARAC disagrees with the proposals. In particular, HoTARAC does not believe that it is appropriate to include credit loss expectations in the amortised cost measurement of financial assets.

As previously expressed in the Request for Information, HoTARAC holds a number of conceptual and practical concerns with the proposed approach. HoTARAC is concerned about the subjective nature of the information and the ability to obtain access to reliable information on which to base estimates. Further, HoTARAC believes the ability to recognise impairment gains may result in manipulation by management.

In particular, HoTARAC considers the presentation and disclosure requirements to be onerous for non-financial institutions, including origination and maturity (vintage) information, and the requirement to disclose a reconciliation for each class of financial asset with an explanation of non-performing assets. In addition, HoTARAC does not support the disclosure of stress testing information, which is dependent on whether this information is prepared for internal risk management purposes, as this may lead to a reduction in the comparability of financial reports.

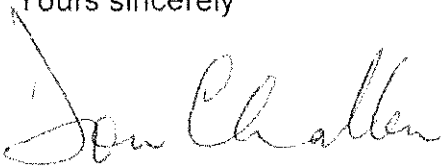
In response to the AASB's specific matters for comment, HoTARAC does not consider there to be any regulatory or other issues which may affect the implementation of the proposals, other than the availability of information on which to base estimates.

Conceptually, HoTARAC does not consider the proposals will improve the usefulness of financial statements for users where non-financial institutions are concerned, as the proposed disclosures for such entities will be extensive and may impede the understandability of those financial statements by users. In addition, the subjectivity of estimated credit losses, in the measurement of amortised cost, may reduce the reliability of estimates and could potentially be misleading to users, given other asset measurement principles do not include such forward looking information.

HoTARAC offers no comment on whether the proposals are in the best interests of the Australian and New Zealand economies.

If you have any queries regarding HoTARAC's comments, please contact Peter Gibson from the Australian Department of Finance and Deregulation on (02) 6215 3551.

Yours sincerely



D W Challen

CHAIR

HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE

13 May 2010

Encl

Contact: Amy McShane
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HoTARAC Comments Exposure Draft 189 Financial Instruments: Amortised Cost and Impairment

1. Is the description of the objective of amortised cost measurement in the exposure draft clear? If not, how would you describe the objective and why?

The majority of HoTARAC members consider the description of the objective of amortised cost measurement to be clear.

A minority of HoTARAC members consider the description of the objective of amortised cost measurement to be unclear due to the mix of historic cost, current information, impairment and amortised cost concepts. It is recommended that this should be made transparent and that the IASB should acknowledge that this is a consequence of a mixed measurement model. This may be achieved through the objective of amortised cost measurement being separated from the objective of impairment of financial assets.

2. Do you believe that the objective of amortised cost set out in the exposure draft is appropriate for that measurement category? If not, why? What objective would you propose and why?

The majority of HoTARAC members believe the objective of amortised cost set out in the ED is appropriate for the measurement category. However, HoTARAC does not support the inclusion of expected credit losses for financial assets in the calculation of amortised cost.

A minority of HoTARAC members do not consider that the objective of amortised cost is appropriate for this measurement category. In addition to the concerns expressed above, these members do not believe the objective is sufficiently broad to cover all financial assets required to be measured at amortised cost; for example the objective concentrates on the effective return and interest which is not relevant to short term receivables. It also does not adequately reflect the impact on the Balance Sheet.

3. Do you agree with the way that the exposure draft is drafted, which emphasises measurement principles accompanied by application guidance but which does not include implementation guidance or illustrative examples? If not, why? How would you prefer the standard to be drafted instead, and why?

HoTARAC agrees with the way the ED is drafted, which emphasises measurement principles accompanied by application guidance. HoTARAC considers that this approach is clearer and less complex than IAS 39 *Financial Instruments: Recognition and Measurement*, where measurement guidance was contained within the definitions. However, HoTARAC considers the final Standard should provide an explicit link to the application guidance as the guidance is an integral part of the Standard. A minority of HoTARAC members consider that application guidance is best located within the body of the Standard.

HoTARAC considers that illustrative examples would be beneficial, particularly for non-financial institutions, given the complexity of the Standard and the reliability/comparability issues. HoTARAC considers the following illustrative examples, similar to the IASB staff examples, to accompany the Standard would be useful:

- fixed rate financial assets;
- variable/floating rate financial assets;
- transitional guidance, such as how the transitional effective interest rate adjustment calculation should work;
- fixed and variable financial liabilities;
- calculation of probability weighted expected cash flows;
- how the allowance account might work in practice; and
- assessment for non-performing financial assets – due to being open to subjectivity, some guidance on collectability may be appropriate.

4. (a) Do you agree with the measurement principles set out in the exposure draft? If not, which of the measurement principles do you disagree with and why?

(b) Are there any other measurement principles that should be added? If so, what are they and why should they be added?

HoTARAC considers that the expected loss approach would overcome some of the weaknesses of the incurred loss model particularly by eliminating the need for a loss trigger, however, HoTARAC holds a number of conceptual and practical concerns with the proposed approach.

Conceptual issues:

- There are conceptual difficulties with the proposed expected loss approach, particularly when compared with the approach to measuring assets in other Accounting Standards. The proposed Standard may be the only Standard that will require entities to anticipate future activities when measuring assets. Such a fundamental issue requires consideration at the conceptual framework level and is not appropriate at the level of an individual Standard.

Further, the development of current Standards includes asset measurement principles which are inconsistent with this approach. For example, in IASB DP/2009/1 *Leases* the International Accounting Standards Board tentatively decided to adopt an amortised cost-based approach to subsequent measurement of right of use assets based on contractual cash flows rather than expected cash flows.

- The measurement of financial liabilities has not been adequately considered in the ED. The ED proposes that the estimated cash flows of financial liabilities do not reflect the entity's own performance risk (AG B3). Essentially, the ED proposes a different measurement approach for financial liabilities and financial assets measured at amortised cost. This may lead to a reduction in comparability between such financial assets and liabilities as the issuer and holder of these financial instruments would be required to account for them differently.
- HoTARAC also considers entities may need additional guidance on the measurement of financial liabilities.
- HoTARAC considers that the IASB should work with regulators in addressing some of the issues encountered in the Global Financial Crisis.

Practical issues

- Significant reservations are held regarding how an entity could obtain access to reliable information to estimate future cash flows as that information may be held by external parties, or historical data may be difficult to obtain or not exist. Reliability concerns will be compounded for non-financial institutions where valuation may be required for individual financial assets and the issue of probability weighted expected cash flows becomes more problematic, without the availability of historical data. The expected cash flows approach puts more onus on entities to ascertain information that may not be readily available to them.
- The prediction of cash flows that are dependent on another entity's circumstances is too subjective and relies heavily on management's assumptions and judgement. HoTARAC supports alternative view AV2 as it does not believe that the results of applying the model will be auditable and thus will not be verifiable due to the subjectivity involved in estimates. It is also unclear to what extent management is bound to consider internal and external evidence and what relative precedence is required to be given to each. As a result, HoTARAC is not convinced that the proposed model necessarily results in better information than the current model. Some HoTARAC members also argue that, by smoothing profit based on expected losses, the proposed model may reduce the quality of information currently provided by applying the incurred loss approach, through not reflecting the world as it is.
- Another example of the subjectivity and limitations of the expected cash flow approach concerns the reversal of impairment losses. While some entities may consider this to be a reversal of the initial impairment, another entity may treat this as a change in accounting estimate and account for it in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

- As noted in BC36 the proposals will allow entities to recognise an impairment gain from a favourable change in credit loss expectation even if no impairment loss has been previously recognised. While HoTARAC recognises that this gain aims to reflect an improvement in the credit quality of the financial asset, HoTARAC is concerned about the possible manipulation of expected loss estimates at initial recognition to recognise future revenue, ie manipulating the expected cash flows and subsequently recognising an impairment gain. This being said, HoTARAC does note that the extent of the gain is limited to the difference between the initial carrying amount and the present value of the full contractual cash flows discounted using the effective interest rate.
- A minority of HoTARAC members also believe that it is unclear from the Exposure Draft what information is to be used as the basis for determining estimates of expected credit losses. For example, Paragraphs IN7, B9, B16 and BC29 do not indicate that predictions of future conditions are expected; rather, historical and current information is referred to. Clearly there is less subjectivity dealing with historical information and current conditions. However, Paragraph BC23 implies that the allowance for losses should be predictive of future credit losses, which may suggest that estimates of credit losses should, at least partially, be based on extrapolations into the future. Also, a user's presumption may be that such estimates are based on predictions of future circumstances. These HoTARAC members consider more clarification should be incorporated into the application guidance about whether predictions of future circumstances are expected.

HoTARAC commends the IASB for acknowledging the cost and implementation issues, previously raised, by providing a longer lead time for implementation.

It is HoTARAC's view that the incurred loss approach would be preferable to the expected loss approach.

One proposal to improve the incurred loss approach could be by requiring the review of estimates at each measurement date as proposed in the ED rather than the delayed trigger method. However, HoTARAC is concerned about the practical application of remeasuring all the financial instruments at each measurement date. If the above approach is adopted, the IASB would need to consider the implications of this.

Another suggestion would be to change the criteria for recognising a provision for impairment and leaving the amortised cost calculation as it currently is.

HoTARAC supports the IASB's conclusion that the alternative impairment approaches, ie fair value approach and through-the-cycle approaches, discussed in BC15 to BC24 are inappropriate.

5. (a) Is the description of the objective of presentation and disclosure in relation to financial instruments measured at amortised cost in the exposure draft clear? If not, how would you describe the objective and why?

(b) Do you believe that the objective of presentation and disclosure in relation to financial instruments measured at amortised cost set out in the exposure draft are appropriate? If not, why? What objective would you propose and why?

HoTARAC considers the objective of presentation and disclosure as set out in the ED to be clear.

However, HoTARAC does not believe the objective of presentation and disclosure as set out in the Exposure Draft is appropriate. HoTARAC believes the objective of presentation and disclosure should be linked to the objective of amortised cost, which should be sufficiently broad to cover all financial instruments measured at amortised cost, including short-term trade receivables.

Further, HoTARAC is concerned about the difficulties in distinguishing between expected credit losses and interest revenue, given expected credit losses are offset against revenue. It may not be possible to separately assess the financial effect of the interest revenue and the quality of the financial assets.

6. Do you agree with the proposed presentation requirements? If not, why? What presentation would you prefer instead and why?

The majority of HoTARAC members broadly agree with the proposed presentation requirements, subject to the following concerns.

It appears that the proposed presentation requires two amortised cost calculations – one based on contractual cash flows and another based on the expected cash flows (including future credit losses). This will increase the burden on financial statement preparers as well as requiring accounting systems to have dual capability.

The presentation requirements seem overly onerous for non-financial institutions that do not hold financial instruments carried at amortised cost, other than non-complex ones such as short-term trade receivables. HoTARAC questions the usefulness and relevance of this information given the entity would not calculate an effective interest rate or recognise interest revenue. HoTARAC believes the IASB needs to reconsider the presentation and disclosure requirements for non-financial entities which only hold such instruments; and provide additional guidance and clarification where necessary, possibly through the practical expedients (also see Question 12).

A minority of HoTARAC members do not agree with the proposed presentation requirements, particularly the proposed additional line items in the Statement of Comprehensive Income. There is a concern that such detail would be inappropriate on the face of this Statement, giving disproportionate attention to financial asset impairment and leading to cumbersome presentation. An alternative would be to present this detail in the Notes to the statements.

7. (a) Do you agree with the proposed disclosure requirements? If not, what disclosure requirements do you disagree with and why?

(b) What other disclosures would you prefer (whether in addition to or instead of the proposed disclosures) and why?

In general, HoTARAC is concerned about the complexity and volume of disclosures and the prescriptive nature of the requirements and considers the proposed disclosures to be onerous for non-financial institutions. Instead, HoTARAC supports a broader more flexible, principles-based approach that reflects how risks are managed. The objective should be to ensure that only relevant information is disclosed for financial and non-financial institutions.

The majority of HoTARAC members support the reconciliation of changes in the allowance account as it provides transparency and useful information regarding the composition of the account. However, HoTARAC questions the usefulness of this information for non-financial institutions which only hold short-term trade receivables. A minority of HoTARAC members do not support the reconciliation of changes in the allowance account, due to the issue of unbundling the expected credit losses from the amortised cost calculation.

HoTARAC also supports the requirement to include qualitative disclosures of estimates and changes in estimates that are required to determine amortised cost for financial instruments other than trade receivables. As reflected in BC57-59, this would be necessary if the IASB's expected loss approach is retained, as it addresses some of the concerns regarding the subjectivity of management estimates under the expected loss model by attributing significant changes in estimates to particular causes.

HoTARAC does not support the disclosure of stress testing and origination and maturity (vintage) information and finds this information particularly irrelevant for non-financial institutions. While HoTARAC members are aware that only entities which prepare stress testing information for internal risk management purposes will be required to disclose this, HoTARAC is concerned that this information is excessive given the other disclosures which are proposed. In addition, HoTARAC is also concerned that this information would be difficult to audit and may lead to a reduction in the comparability of such information in financial reports.

While HoTARAC members agree that the origination and maturity information may be useful and appropriate for financial institutions, this would not be as relevant for non-financial institutions and may impose an additional disclosure burden without commensurate benefit to users. In addition, the proposals need to accommodate financial assets that have no maturity dates, which may be allowed by public sector lenders.

Further, HoTARAC is concerned that the definition and discussion regarding non-performing assets and write-offs is too prescriptive. That is, the nature of financial assets differ, as do practices across countries, such that specifying a number of days past due, may be inappropriate. Similarly, HoTARAC members are not sure that it is necessary for enforcement activities to have ceased before being able to consider an item as uncollectible, for example it could be assumed uncollectible after 12 months for reporting purposes.

HoTARAC questions how this will link with IFRS 7 *Financial Instruments: Disclosures*. An alternative would be for the IASB to consider such disclosures as part of IFRS 7 rather than a Recognition and Measurement Standard.

8. Would a mandatory effective date of about three years after the date of issue of the IFRS allow sufficient lead-time for implementing the proposed requirements? If not, what would be an appropriate lead-time and why?

Given the extent and complexity of the proposals, HoTARAC agrees with the IASB's proposed lead-time of three years, as opposed to the usual 6-18 month effective date.

9. (a) Do you agree with the proposed transition requirements? If not, why? What transition approach would you propose instead and why?

(b) Would you prefer the alternative transition approach (described above in the summary of the transition requirements)? If so, why?

(c) Do you agree that comparative information should be restated to reflect the proposed requirements? If not, what would you prefer instead and why? If you believe that the requirement to restate comparative information would affect the lead-time (see Question 8) please describe why and to what extent.

(a) HoTARAC agrees with the proposed transition requirements, and considers it to be the most appropriate approach compared to the alternatives put forward by the Board. However, HoTARAC considers an illustrative example of the transitional effective interest rate adjustment would be beneficial.

(b) While the customised transition approach appears simpler and less onerous, HoTARAC does not support this approach due to its negative effect on equity and interest revenue after transition. This approach uses the original effective interest rate determined in accordance with IAS 39 (not including credit loss expectations) to be applied to expected cash flows (including credit loss expectations). As set out in the Basis for Conclusions, this will result in lower cash flows discounted at a higher discount rate which will distort interest revenue after transition (BC71).

(c) HoTARAC agrees that comparative information should be restated to reflect the proposed requirements, but only if subject to reasonable practicality requirements.

10. Do you agree with the proposed disclosure requirements in relation to transition? If not, what would you propose instead and why?

HoTARAC agrees with the proposed disclosure requirements in relation to transition.

11. Do you agree that the proposed guidance on practical expedients is appropriate? If not, why? What would you propose instead and why?

HoTARAC agrees that the proposed guidance on practical expedients is appropriate. However, HoTARAC considers that the practical expedients should be further developed, particularly for non-financial institutions (which are less likely to have historical loss data and where practical expedients become more important). In this regard, HoTARAC members are concerned that the practical expedients are only available where their impact is immaterial. This would require periodically demonstrating that it is immaterial, which potentially undermines the benefits of the practical expedients and may not be cost effective.

12. Do you believe additional guidance on practical expedients should be provided? If so, what guidance would you propose and why? How closely do you think any additional practical expedients would approximate the outcome that would result from the proposed requirements, and what is the basis for your assessment?

While the practical expedients proposed in relation to short-term receivables are highly desirable, HoTARAC considers the practical expedients for short-term receivables should be extended to presentation and disclosure requirements. For example:

- How would the presentation work where there is no interest revenue? (also see response to Question 6); and
- Some of the proposed disclosure requirements would likely be impractical such as stress testing information, origination and maturity information etc.



Grant Thornton

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20 May 2010

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Dear Kevin

Exposure Draft ED 189 & ED/2009/12 - Financial Instruments: Amortised Cost and Impairment

Grant Thornton Australia Limited (Grant Thornton) is pleased to provide the Australian Accounting Standards Board with its comments on ED 189 which is a re-badged copy of the International Accounting Standards Board's (the Board) Exposure Draft ED/2009/12 (the ED). We have considered the ED and set out our comments below.

Grant Thornton's response reflects our position as auditors and business advisers both to listed companies and privately held companies and businesses, and this submission has benefited with some initial input from our clients, Grant Thornton International which is working on a global submission to the IASB, and discussions with key constituents.

The views expressed here are preliminary in nature, and a more detailed Grant Thornton global submission will be finalised by the IASB's due date of 30 June 2010.

Our responses to the questions in the ED's Invitation to Comment, along with a number of drafting suggestions, are set out in the Appendix.

Summary of our views

Our principal comments are as follows:

- We do not support the mandatory application of this proposed accounting standard to non-publicly accountable entities as the requirements are far too complex and costly for such entities and note that the IASB is not requiring any such mandatory application. We therefore believe it is extremely important that the AASB allows non-publicly accountable entities to have the option of using the IASB's IFRS for SMEs accounting standard (which the IASB has specifically designed for such entities) as an alternative to adopting this proposed accounting standard.

- We commend the Board for acknowledging problems with the incurred loss impairment approach, which became more evident during the financial crisis. We support the Board in its attempts to address those weaknesses.
- We also note however that the approach to classification and measurement of financial assets adopted in phase I of IFRS 9 Financial Instruments addresses some of the problematic aspects of the impairment requirements in IAS 39 Financial Instruments: Recognition and Measurement (IAS 39).
- We believe that the expected loss approach proposed has theoretical advantages. In particular we believe that a model that incorporates expectations of default into measurement and income recognition throughout the life of a financial asset better reflects the economics of a lending business. We also agree that a measurement that uses current estimates of expected future cash flows will provide relevant information.
- We are however concerned that the operational challenges of implementing the proposed approach may result in cost and complexity that exceeds its benefits. Moreover, we believe that these challenges could be disproportionately burdensome for many non-financial institutions. We suggest that additional (and more effective) practical expedients are needed if the benefits of an expected loss approach are not to be outweighed by its costs.
- We support the Board's tentative decision to reject impairment approaches based either on fair value and or on loss estimates that do not reflect the existing loan portfolio and current conditions.

We expand on these comments in the following paragraphs.

Issues with the IAS 39 incurred loss approach

The existing requirements of IAS 39 were tested by the financial crisis and in the eyes of many were found to be wanting. A number of the criticisms expressed are mentioned in BC11 to the ED. In addition we also note that the existing requirements of IAS 39 result in:

- different bases for measuring impairment losses depending on how an instrument is classified (as available for sale or within loans and receivables or held to maturity)
- the inability to reverse impairment losses recognised in profit or loss on available-for-sale equity instruments
- some assets carried at amortised cost being assessed for impairment both individually and as part of a collective assessment.

We support the Board's acknowledgment of shortcomings in the current approach, and its efforts to develop an improved model. We note also that the introduction of IFRS 9's classification and measurement model addresses the first two of these points. The case for further changes to impairment requirements is now perhaps less compelling (although we nonetheless support the Board's efforts to make further improvements).

Expected loss approach - benefits and challenges

We agree that the use of an expected cash flow approach to recognising impairments on assets held at amortised cost will result in more forward looking information being presented in financial statements.

For lending businesses, we believe that the proposed approach is also more consistent with the business model. For a lending business, assessing the possibility of credit losses is an integral factor in making lending decisions and in pricing the risks assumed. It therefore seems appropriate to incorporate the possibility of credit losses, and changes to that possibility, in the measurement of loans and allocation of income over the life of the instrument. Compared to IAS 39's incurred loss approach, such an approach will more closely reflect current economic conditions and management expectations at the reporting date.

We are however concerned that the costs of the proposed approach could outweigh the benefits - in particular for many non-financial entities whose primary financial assets in concern are normal trade receivables. This is because:

- We acknowledge that any entity that provides credit is exposed to a risk of credit losses that needs to be managed. However, we also note that the financial crisis-related criticisms of the incurred loss approach arose mainly in the context of financial institutions. Despite the conceptual advantages of incorporating expected credit losses into amortised cost measurement generally, it is not obvious that the existing model has been proved deficient in practice outside the financial sector.
- Many non-financial entities follow a business model which differs markedly from that used by a financial institution. Providing credit to customers in the form of normal trade receivables is usually a necessary but incidental activity. The assessment of customers' credit-worthiness is usually unsophisticated and credit risk is not explicitly priced into the terms of trade. It is therefore questionable whether the ED's proposed approach is consistent with the business models of most non-financial entities.
- We believe that the proposals will present most entities with operational challenges. Furthermore, we expect that non-financial institutions will in general be less familiar with some of the techniques involved and also have less data on which to base their expected loss estimates.
- We also note that some of the terminology used in the ED is somewhat technical and appears to be oriented towards more sophisticated financial institutions.

We note that the Board has established an Expert Advisory Panel to provide advice on dealing with the operational problems that are likely to be encountered. We welcome this initiative and note that it will be important for the Board to consider carefully the advice of that Panel when deciding how to progress the project. We hope that the Panel will devote adequate time to implementation issues for non-financial institutions as well as to banks and other financial services entities.

Despite these comments, we do not advocate differential industry-based requirements on impairment of financial assets. Rather, we suggest that the Board should consider the need for additional, and more effective, practical expedients with a particular focus on instruments most commonly held by non-financial institutions.

Practical expedients

To alleviate the operational problems noted above, we believe that practical expedients will be needed in any final Standard.

We note and welcome the inclusion of proposed practical expedients and guidance on their use in the ED. We are concerned however that the ED constrains their use to situations where their overall effect (in comparison to the general approach) is immaterial. We believe this will reduce or negate the benefits of practical expedients.

In addition, we believe that further practical expedients should be considered for variable rate financial assets. We suggest that such an expedient could be scoped in terms of the type of activity for which an asset is held, possibly by relating use of the expedient to the reporting entity's business model.

Alternative impairment approaches

We agree with the Board's decision to reject a fair value-based approach to impairment. The Board notes that such an approach would in effect require fair value accounting on a contingent basis. In addition we believe that a fair value-based model would undermine the Board's decision to retain a mixed measurement model for classification and measurement of financial assets in IFRS 9.

We also support the Board in deciding to reject approaches to impairment based on through the cycle or dynamic provisioning. We agree that such impairment approaches could result in the recognition of losses on contracts that have not yet been entered into at the balance sheet date and are unrepresentative of the underlying economic characteristics of the financial asset as held at the reporting date.

We note also that a number of other bodies are currently looking at alternative methods of amortised cost and impairment accounting that would permit earlier recognition of credit losses than under the current incurred loss model. We understand that the European Banking Federation is considering a model that would keep the calculation of the effective interest rate separate from the recognition of expected losses, while the US Financial Accounting Standards Board is considering developing an approach to impairment that would be based on an enhanced version of the incurred loss model currently used. The Board may wish to consider the merits of these alternative approaches when more detail is known about them.

Pro- and counter-cyclical effects

We note that the existing incurred loss impairment approach has been criticised for producing financial statement information that has exacerbated the swings of the economic

cycle. It has been argued by some that earlier recognition of credit losses (as is envisaged by the proposed approach) may serve to reduce those cyclical swings. We question whether this will be the case however, as the proposed approach may still have pro-cyclical effects during a long period of benign credit losses. For example if actual losses turn out to be lower than expected over an extended period, then credits will be recognised in profit or loss and unexpected loss events (by their very nature) will not be anticipated.

We therefore recommend that the effects of the proposed approach in terms of pro-cyclicality or counter-cyclicality are not considered by the Board in deciding whether to implement the proposed approach.

We expand on these comments in our answers to the invitation to comment questions.

If you require any further information or comment, please contact me.

Yours sincerely
GRANT THORNTON AUSTRALIA LIMITED



Keith Reilly
National Head of Professional Standards

Appendix

IASB Invitation to comment questions

Objective of amortised cost measurement (paragraphs 3-5)

- 1 Is the description of the objective of amortised cost measurement in the exposure draft clear? If not, how would you describe the objective and why?

We believe that the description of the objective of amortised cost measurement in the ED is clear as far as it goes. We note however that, as currently worded, the objective emphasises solely the allocation of interest revenue or interest expense. For reasons we expand on in our response to Question 2, we would like the objective to also refer to repayments of principal. We have included a drafting suggestion to accomplish this at the end of this Appendix.

- 2 Do you believe that the objective of amortised cost set out in the exposure draft is appropriate for that measurement category? If not, why? What objective would you propose and why?

For financial institutions engaged in lending business, we believe the objective of amortised cost set out in the ED is appropriate as currently worded. We say this because their primary interest is earning a lender's return and the draft objective captures this.

We have some doubt over the appropriateness of the objective for assets at amortised cost which are held for reasons other than earning a lender's return. For many entities, the time value of money in relation to trade receivables is incidental to the collection or repayment of the principal amount, and is effectively viewed as part of the sales process. As discussed in our response to Question 1, we therefore suggest that the emphasis on interest revenue and interest expense needs to be reduced by incorporating reference to the repayment of the principal amount in the description of the objective.

More generally, it is questionable whether the proposed approach will provide more useful information for entities whose financial assets are short-term trade receivables. We therefore encourage the IASB to consider scope exclusion for short-term trade receivables where they are held by a reporting entity whose business model is not that of a lender.

Measurement principles (paragraphs 6-10)

- 3 Do you agree with the way that the exposure draft is drafted, which emphasises measurement principles accompanied by application guidance but which does not include implementation guidance or illustrative examples? If not, why? How would you prefer the standard to be drafted instead, and why?

We support the use of principles-based approaches wherever possible, and therefore welcome the way in which the ED has been drafted. We believe the ED to be an improvement on IAS 39, which included numerous different approaches to impairment.

We include some drafting suggestions on the measurement principles at the end of this Appendix

- 4 (a) Do you agree with the measurement principles set out in the exposure draft? If not, which of the measurement principles do you disagree with and why?

For the reasons set out in our covering letter, we agree with the Board's decision to reject impairment approaches based on fair value or on loss estimates that do not reflect the existing loan portfolio and current conditions.

We also agree that having information based on expected cash flows at each measurement date will address the problem of the delayed recognition of impairment losses, which is the main conceptual problem with the current incurred loss model. The expected cash flow approach proposed also eliminates the need for an incurred loss trigger, thereby avoiding the problems in determining when that trigger is activated.

We feel however that the application of measurement principles for variable rate instruments will not be readily understood by many preparers, in particular the process for re-evaluating the effective interest rate on such instruments. As noted earlier, we suggest that a practical expedient may be needed for such instruments.

- 4 (b) Are there any other measurement principles that should be added? If so, what are they and why should they be added?

We believe that greater emphasis should be given to the repayment of principal in the ED's discussion of expected cash flows. While paragraph B1 in the Application guidance to the ED refers to principal repayment, it is not currently discussed in the main body of the ED. We suggest that it may be worth preceding paragraphs 6 to 10 with a description of amortised cost similar to that contained in the first paragraph B1.

Objective of presentation and disclosure (paragraphs 11 and 12)

- 5 (a) Is the description of the objective of presentation and disclosure in relation to financial instruments measured at amortised cost in the exposure draft clear? If not, how would you describe the objective and why?

Yes, we believe that the objective set out in the ED is clear.

- 5 (b) Do you believe that the objective of presentation and disclosure in relation to financial instruments measured at amortised cost set out in the exposure draft is appropriate? If not, why? What objective would you propose and why?

We question whether an objective of presenting and disclosing information that enables users of the financial statements to evaluate the financial effect of interest revenue and expense is appropriate for entities that hold mainly short-term trade receivables and payables.

We also question whether the objective-based approach is undermined by paragraph 12(a) and the requirement to present what is essentially a list of disclosures as set out in paragraph 13-22 of the ED.

Presentation (paragraph 13)

- 6 Do you agree with the proposed presentation requirements? If not, why? What presentation would you prefer instead and why?

We agree that the proposed presentation requirements are, at a general level, appropriate in terms of the measurement approach proposed in the ED.

We believe that requiring disclosure of the items listed in paragraph 13 on the face of the Statement of Comprehensive Income risks clutter however. We suggest that disclosure of these items should only be required on the face of the Statement of Comprehensive Income where it is relevant to an understanding of the entity's financial performance; where this is not the case, disclosure in the notes to the financial statements should suffice.

Disclosure (paragraph 14-22)

- 7 (a) Do you agree with the proposed disclosure requirements? If not, what disclosure requirement do you disagree with and why?

As noted above, we believe that the ED takes an overly prescriptive approach to disclosure. This approach does not fit well with the high level objective set out in paragraph 11 of the ED. We would prefer entities to have more discretion to disclose only those matters which are relevant to an understanding of the entity's financial performance and position. As currently drafted, the list of information to be presented is very long, and may be excessive for entities holding financial instruments that consist mainly of short-term trade receivables and trade payables. We recommend then that the Board re-evaluates the usefulness of the information proposed in relation to its benefits. It may indeed be sensible to provide a practical expedient which would have the effect of exempting some financial assets and liabilities from the disclosure requirements of the proposed Standard on cost-benefit grounds, particularly where they are not held for the provision of finance.

In addition to these general remarks, we have the following specific comments on the proposed disclosures:

Classes of financial instruments and level of disclosure

In relation to the proposed disclosure, we note that 'class of financial asset or financial liability' is not defined. Guidance on aggregation may therefore be needed if the benefits from providing this information are not to be outweighed by the costs of collecting it.

Allowance account and Estimates and changes in estimates

We note that 'credit loss' is not a defined term in the Standard and may be problematic to interpret given that expected credit losses form an integral part of the amortised cost of the asset in concern under the proposals.

That aside, we agree that an analysis of the allowance account is useful. We believe however that a comparison of actual credit losses to expected credit losses will be more useful information given the necessity for management judgement in applying the proposed approach and we therefore support disclosure of the 'loss triangle' proposed in paragraph 19. Such a comparison has been shown to be useful information in other areas with a high degree of estimation uncertainty (such as retirement benefits).

In relation to the specific disclosures proposed, however, we note that as currently worded, there appears to be no time limit to the comparison between the development of the credit loss allowance over time and cumulative write-offs required by paragraph 19(a). This point could usefully be clarified.

Also in relation to paragraph 19, we note again that a class of assets needs to be defined and guidance provided on aggregation.

Stress testing

The proposed stress testing disclosures could be viewed as penalising entities that prepare such information for internal use. We note, however, that IFRS 7 contains precedents for adopting such an approach. Some entities which do not perform stress testing at present may decide to implement it in order to demonstrate best practice. We also note that the IASB has sought to minimise the costs of compliance with this requirement by specifying that the disclosure should be through the eyes of management. On balance we support the proposal.

Credit quality of financial assets

We agree that the existing disclosure requirements in this area are weak. It is right that the Board is seeking to address these weaknesses, and we support the proposed disclosure.

Origination and maturity information

We believe that entities with large numbers of financial assets are likely to find the proposed disclosure onerous to comply with. We believe then that guidance should be provided on how to aggregate the information to be disclosed, for example through the use of time bands.

- 7 (b) What other disclosures would you prefer (whether in addition to or instead of the proposed disclosures) and why?

We do not propose any additional disclosures.

Effective date and transition (paragraphs 23-29)

- 8 Would a mandatory effective date of about three years after the date of issue of the IFRS allow sufficient lead-time for implementing the proposed requirements? If not, what would be an appropriate lead-time and why?

We foresee considerable operational difficulties in moving to the proposed approach. Changes will need to be made to systems, and there will be costs in collecting and analysing the information needed to apply the proposed approach. Entities that have never collected such data will experience particular problems.

We agree then that a lengthy lead time will be needed for implementing the proposed approach. We believe that a proposed effective date of about three years after the date of issue of the IFRS is appropriate.

- 9 (a) Do you agree with the proposed transition requirements? If not, why? What transition approach would you propose instead and why?

Although we generally support retrospective application wherever possible, we recognise that significant operational problems are likely to be encountered in implementing the new approach. We also note that the IASB has already departed from the policy of general retrospective application in other projects on cost-benefit grounds. We therefore support the proposed transition requirements for providing a pragmatic solution to the issue of comparability by approximating the effective interest rate that would have been determined if the approach in the ED had always been in use.

- 9 (b) Would you prefer the alternative transition approach (described above in the summary of the transition requirements)? If so, why?

We do not support the alternative transition approach of providing an exception to prospective application under which entities would be permitted to choose retrospective application if the information required to do so is available without using hindsight, and the previous IAS 39 effective interest rate would be used for other instruments that were initially recognised before adoption of the proposed approach.

We believe that such an approach is inappropriate as it would create a lack of comparability between individual instruments that were recognised before adoption of the proposed approach as well as between instruments initially recognised either side of the transition date.

We also agree with the Board in rejecting the 'collar-based' approach for the reasons outlined in BC 74 to the ED.

- 9 (c) Do you agree that comparative information should be restated to reflect the proposed requirements? If not, what would you prefer instead and why? If you believe that the requirement to restate comparative information would affect the lead-time (see Question 8) please describe why and to what extent.

We agree that full prospective application is not appropriate as it is likely to lead to 'grandfathering' the incurred loss model for a significant volume of financial instruments for many years. We therefore believe that comparative information should be restated in accordance with the adjusted effective interest rate alternative proposed in the ED.

- 10 Do you agree with the proposed disclosure requirements in relation to transition? If not, what would you propose instead and why?

We agree with the proposed disclosure requirements.

Practical expedients (paragraphs B15-B17)

- 11 Do you agree that the proposed guidance on practical expedients is appropriate? If not, why? What would you propose instead and why?

We welcome the Board's recognition of cost-benefit considerations in proposing the use of practical expedients, and we support the inclusion of such expedients in any final Standard. We are concerned, however, over the wording in B15 of the ED, which states that an entity may use practical expedients in calculating amortised cost if their overall effect is immaterial. In our view, it will be problematic to ensure that effect of using a practical expedient is immaterial without actually also applying the general expected loss measurement requirements in full. We believe that the wording of this paragraph needs to change for it to be effective, and we have included a drafting suggestion to accomplish this at the end of this Appendix.

- 12 Do you believe additional guidance on practical expedients should be provided? If so, what guidance would you propose and why? How closely do you think any additional practical expedients would approximate the outcome that would result from the proposed requirements, and what is the basis for your assessment?

We believe that the introduction of a practical expedient for variable rate financial assets should be considered.

Some of the terminology used in the ED is somewhat technical and appears to be oriented towards more sophisticated financial institutions. Phrases such as 'derive the forward yield curve from the spot yield curve' and 'determine the expected spread by iteration' are unlikely to be familiar to such entities, and therefore less likely to be readily understood. Preparers

may also be confused by monies collected on receivables being allocated partially to revenue and partially to gains if they are not used to thinking about the advancement of credit on trade receivables in terms of a lending decision. We therefore believe that the need for a practical expedient should be considered if the benefits of the approach proposed in the ED are not to be outweighed by the costs of implementing it.

Drafting suggestions

We have the following suggestions on possible improvements to the drafting of the ED:

Paragraph 2

We suggest the description of the objective of amortised cost measurement should refer to the repayment of the principal of the financial instrument. Our suggested wording is:

"The objective of amortised cost measurement is to provide information about the effective return on, and the ultimate repayment of the principal amount of, a financial asset or financial liability by allocating interest revenue or interest expense over the expected life of the financial instrument."

Paragraphs 6 - 10

Expected credit losses are incorporated only into the measurement of amortised cost financial assets, not financial liabilities. This is an important point that is not made explicitly in the main body of the Exposure Draft. The point is made by implication in paragraph 5 of the ED but is only made explicitly in paragraph B3(c). We suggest replacing paragraph 5 with the following:

"The effective return reflects an allocation over the expected life of the instrument of fees, points paid or received, transaction costs and other premiums or discounts. The effective return includes the initial estimate of expected credit losses for financial assets but not for financial liabilities."

Paragraph 7

We also found the wording of paragraph 7 of the ED to be unduly complicated, and believe that it could be better expressed. We suggest paragraph 7 is replaced with the following:

"Amortised cost reflects at each measurement date current inputs regarding the cash flow estimates. As a cost-based measurement, amortised cost also reflects an input relating to initial measurement, which is the effective interest rate to the extent that it is not contractually reset to current conditions. For a fixed rate financial instrument where no component of the contractual interest is reset, this is the effective interest rate at initial recognition. For a floating rate financial instrument, the effective interest rate at initial recognition is updated to reflect the resetting of the benchmark interest while the effective spread determined at initial recognition remains constant."

Paragraph B15

We suggest the first sentence of paragraph B15 is replaced with the following:

"An entity may use practical expedients in calculating amortised cost if their overall effect is immaterial."

Specific AASB Questions

- 1 Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:
 - a not-for-profit entities; and
 - b public sector entities;

We are not aware of any regulatory issues that may affect the implementation of the proposals except as detailed in our earlier comments and particularly as they relate to non-publicly accountable entities. We do not support the mandatory application of this proposed accounting standard to non-publicly accountable entities as the requirements are far too complex and costly for such entities and note that the IASB is not requiring any such mandatory application. We therefore believe it is extremely important that the AASB allows non-publicly accountable entities to have the option of using the IASB's IFRS for SMEs accounting standard (which the IASB has specifically designed for such entities) as an alternative to adopting this proposed accounting standard.

More specifically on the questions raised, we would suggest that most, if not all not-for-profit organisations would be non-publicly accountable, but note that this is a Differential Reporting issue that is currently before the AASB. Whether some not-for-profit entities should be considered publically accountable (based on a size test perhaps) should warrant further consideration by the AASB.

Similarly we believe that there should be some public sector entities (again based on a size test) that should not be considered "publicly accountable". This is a matter we believe should be further considered by the AASB, in conjunction with the Commonwealth, State and Local governments to individually clarify, as detailed in our ED 192 Differential Reporting submission.

- 2 Overall, the proposals would result in financial statements that would be useful to users;

Our detailed comments need to be taken into account before we are able to state that we believe that the proposals will result in financial statements that would be useful to users. In particular we do not support the mandatory application to non-publicly accountable entities as detailed elsewhere in our submission.

- 3 Whether the proposals are in the best interests of the Australian and New Zealand economies.

Our detailed comments need to be taken into account before we are able to state that the proposals are in the best interests of the Australian and New Zealand economies. In particular we do not support the mandatory application to non-publicly accountable entities as detailed elsewhere in our submission.

21 May 2010

Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West Victoria 8007

Via email: standard@asb.gov.au

Dear Mr Stevenson

Comments on Exposure Draft 189 Financial Instruments: Amortised Cost and Impairment

Thank you for the opportunity to comment on the AASB Exposure Draft 181 Fair Value Measurement. CPA Australia, the Institute of Chartered Accountants (the Institute), and the National Institute of Accountants (the Joint Accounting Bodies) have considered the above exposure draft (ED) and our comments follow.

The Joint Accounting Bodies represent over 180,000 professional accountants in Australia. Our members work in diverse roles across public practice, commerce, industry, government, academia throughout Australia and internationally.

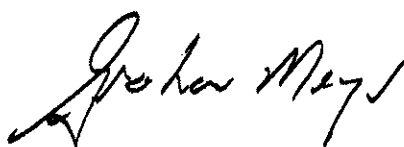
We are unable to support the ED, and we have attached our submission to the IASB which explains our reasons. We understand you are in the process of 'outreaching' to the Australian and Asian banking communities, asking them to provide you with more information on applying the current model. We commend you on these efforts as we consider that more guidance on the current model would be preferable as an interim solution until full convergence with the US can be achieved in this area. Given this, we do not consider the expected loss proposals would result in useful financial statements to users and would not be in the best interests of the Australian and New Zealand economies.

If you have any questions regarding this submission, please do not hesitate to contact either Mark Shying (CPA Australia) at mark.shying@cpaaustralia.com.au, Kerry Hicks (the Institute) at kerry.hicks@charteredaccountants.com.au or Tom Ravlic (NIA) at tom.ravlic@nia.org.au.

Yours sincerely



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21 May 2010

Sir David Tweedie
International Accounting Standards Board
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Via "Open to comment" page on www.iasb.org

Dear Sir David

Comments on Exposure Draft ED/2009/12 Financial Instruments: Amortised Cost and Impairment

Thank you for the opportunity to comment on the IASB Exposure Draft Financial Instruments: Amortised Cost and Impairment. CPA Australia, The Institute of Chartered Accountants (the Institute), and the National Institute of Accountants (the Joint Accounting Bodies) have considered the above exposure draft (ED) and our comments follow.

The Joint Accounting Bodies represent over 180,000 professional accountants in Australia. Our members work in diverse roles across public practice, commerce, industry, government and academia throughout Australia and internationally.

One result of the global financial crisis was a call to accounting standard setters from various international groups and bodies such as the G20 to improve the accounting for financial instruments, in particular impairment. We acknowledge the efforts of the IASB to deliver a suitable response. However, the proposals in the ED do not achieve convergence with US GAAP and as a result we are unable to support it at this time. The proposals appear to be inconsistent with a true amortised cost measurement model and inconsistent with other IFRS standards and projects. It is for these reasons the IASB should defer its own consideration of the current exposure draft and work with the Financial Accounting Standards Board (FASB) to expose for public comment a comprehensive articulation of an agreed proposed approach to impairment. We offer the following observations on the content of the ED and hope the IASB finds them useful in understanding our concerns.

Convergence

We are disappointed that the FASB and IASB have gone their separate ways and are producing different requirements for financial instruments when an acknowledged objective of joint work is to eliminate differences between the two bodies of accounting literature. The FASB will soon issue its exposure draft on accounting for financial instruments, which along with being different to the IASB's final decisions on classification and measurement will propose an incurred loss model. It is unfortunate timing as it would have been useful for constituents to have had the time to fully understand the FASB proposals before commenting on the IASB's proposals for impairment. Once again we strongly urge the boards to work more closely together in coordinating their work on joint projects and on the issuance of pronouncements.

Representatives of the Australian Accounting Profession



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Proposals not true to the Framework and other projects

The ED refers to amortised cost as a cost-based measurement however the way it is described in the proposals does not appear to be a true reflection of a cost-based measurement for the reasons outlined below.

In the conceptual framework project, one of the measurement approaches tentatively decided on (in January 2009) was "actual past entry prices adjusted for interest accruals, depreciation, amortization, impairments, and similar things". In the report to the boards in April 2007, this measurement approach was referred to as 'modified past amount' and defined as 'the remainder of an asset's (or a liability's) original past entry price ...after assigning some of that price to subsequent accounting periods, according to an accounting rule for amortization...'. The proposals do not appear to fit this definition, given that the proposals require amortised cost to reflect current inputs regarding cash flow estimates at each measurement date. Paragraph BC 47 of the ED states the fact that the effective interest rate is set at initial recognition and is used as the discount rate (instead of using a current market rate) means that amortised cost is a cost-based measurement. We consider the fact that forward looking information is required in the measurement suggests that this is not a cost-based measurement as defined in the current position of the conceptual framework project.

There are also inconsistencies noted with other projects. The revenue recognition project focuses on contractual rights, whereas the focus of the ED is on expectations and mixes revenue recognition with expense recognition. The liabilities project (amendments to IAS 37) focuses on present obligation and reliable measurement, and has removed the probability criterion so that the focus shifts from predicting the likely outcome to judging whether the entity has an obligation. The expected loss model however is proposing the opposite – it removes the judgement of whether a loss event has occurred to instead require predicting a likely outcome.

The current framework defines income and expenses as increases/decreases in future economic benefits *during* the accounting period. This would be contrary to the ED which would require an entity to book *future* expected losses into the *current* accounting period. This would also be contrary to the requirement in IAS 37 that future operating losses cannot be provided for. The expected loss model is also inconsistent with the way in which other assets are assessed for impairment under IAS 36 *Impairment of assets*, which requires the identification of impairment indicators. The existence of two different impairment models for assets is unsupported and further highlights the need for the conceptual framework to be completed so new or revised standards are consistent with a core set of principles and with each other.

Cost

Despite acknowledging that the expected loss model would be costly to apply given the responses from the ITC, it appears that the IASB has ignored this in paragraph BC30. We do not consider the arguments put forward in BC30 to be valid, as the degree of estimation and uncertainty that these proposals would introduce would be at a very high level, as noted in the alternative views, paragraph AV2.

Smoothing

We are also concerned that the expected loss model would give management a way to manipulate profit. Paragraphs BC 35-36 note that an entity is required to revise its estimates which can give rise to gains even if no impairment had been previously recognised and impairment reversals. Given that the expected loss model relies on expectations only and not on more substantial evidence such as a debtor defaulting, will allow entities to take advantage of it in order to get the result they are after. Paragraph BC30 notes that estimation uncertainty and the use of assumptions is not new however the increased focus on fair values and other areas where estimation and assumptions are required will ultimately have an impact on how and whether these items can be audited.

We do not believe the expected loss model would provide useful information to users either as it attempts to project what the financial impact will be in some future period instead of reporting on what the present current financial impact is. Where there is evidence to suggest

that a debtor is impaired, then surely this is more relevant and reliable information to users than what management considers might happen in the future? The role of financial statements should not be to predict future events but to provide relevant and reliable information based on current or historical data.

Non-financial institutions

The proposals are overly complex, not just for financial institutions, but more so for other entities having few financial assets other than non-interest bearing receivables. As noted earlier, the ED mixes revenue recognition with expense recognition, which is even more of a concern for these other entities given that impairment of debtors is typically treated as an operating expense and accounted for separately from revenue. Not only would the proposals be difficult for financial institutions to apply in practice, but it will also be an unnecessary burden on other entities. We consider it important that a separate section for receivables such as trade receivables be developed that makes clear that simple calculation of losses will suffice as there are no interest payments.

Concluding comments

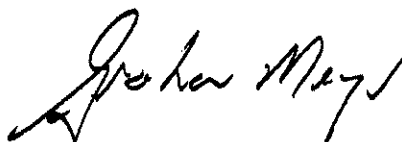
Australia's experience with applying the incurred loss model is generally positive but we can understand that each jurisdiction may interpret the existing requirements differently. An interim solution (with the final goal being convergence with US GAAP) may be to provide additional guidance that better articulates the existing model (as opposed to providing examples to illustrate the application of the existing model), instead of replacing it with a complex model that will be extremely difficult to implement and apply, will not provide users with reliable and relevant information and does not achieve convergence.

If you have any questions regarding this submission, please do not hesitate to contact either Mark Shying (CPA Australia) at mark.shying@cpaaustralia.com.au, Kerry Hicks (the Institute) at kerry.hicks@charteredaccountants.com.au or Tom Ravlic (National Institute of Accountants) at tom.ravlic@nia.org.au.

Yours sincerely



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