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Sir David Tweedie  
Chairman  
International Accounting Standards Board  
First Floor, 30 Cannon Street  
London EC4M 6XH  
UNITED KINGDOM

Dear Sir David

**Exposure Draft ED/2009/7: Financial Instruments – Classification and Measurement**

Thank you for the opportunity to comment on the Exposure Draft on the classification and measurement of financial instruments. We support a simplified approach to this topic, but highlight a number of concerns with the model as it is currently drafted. If these areas are addressed we believe that the approach would represent a significant improvement from the current requirements.

Australia and New Zealand Banking Group Limited (ANZ) is listed on the Australian Stock Exchange and remains one of a select group of banks who continue to be AA rated. Our operations are predominantly based in Australia, New Zealand and Asia and our most recent annual results reported profits of USD2.6 billion and total assets of USD376 billion.

Whilst we are aware of urgency in responding to some of the concerns and shortcomings exposed by global financial crisis we do express concern about the breadth of change currently being contemplated. The desire and need for changes to classification of financial instruments is apparent, however there are a number of other projects where we see less critical need for change (namely Leases, Consolidation, Presentation of Financial Statements) and we encourage the IASB to focus on the most critical items, rather than risk sub-optimal standard setting across a range of topics.

In concept we are supportive of a simplified approach to the classification of financial instruments between fair value and cost and the majority of our concerns revolve around the definition of what goes into each of these categories. Importantly retaining the ability to bifurcate derivatives is a practical way to address these concerns, as the proposed model result in an instrument with a derivative of nominal value to be forced into fair value model. Such an approach is of particular concern in relation to hybrid debt instruments given the recent impact of own name credit on the valuation of these liabilities.

In addition we suggest that an entity's business model be a more significant determinant of the appropriate classification of financial instrument as this will drive the way in which the value of an asset or liability will be crystallised and consequently should be valued. Such an approach recognises that different entities may hold the same instrument for different reasons and should therefore have the ability to account for the instrument in a manner commensurate with the reason for holding the instrument.

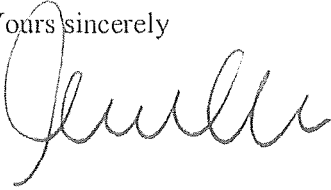
Our other major concern is that the classification of equity instruments at fair value through other comprehensive income means that there is no ability to recognise dividends on these investments as income and that the prevention re-cycling of realised gains further diminishes the relevance of statutory profit as a measure of performance.

We recognise that Other Comprehensive Income (OCI) currently represents an unusual collection of unrelated items and highlight that if there is a growing use of this mechanism to record changes in fair value that there is clear distinction between the nature of OCI and the nature of statutory profit as a performance measure.

The observations made in this letter are limited to the extent that there is no clarity on the proposed changes in related areas such as hedging, impact of own name credit on fair value and equity accounting. If a piecemeal approach to accounting standard revisions is considered the most expedient approach in the current environment then we hope that there is flexibility in revising accounting guidance for the classification and measurement of financial instruments in light of subsequent changes in other areas.

Should you have any queries on our comments, please contact Rob Goss, Head of Accounting Policy, Governance and Compliance at [Rob.Goss@anz.com](mailto:Rob.Goss@anz.com).

Yours sincerely



SHANE BUGGLE  
Group General Manager Finance

Copy: Australian Accounting Standards Board (AASB)

**Question 1 - Does amortised cost provide decision-useful information for a financial asset or financial liability that has basic loan features and is managed on a contractual yield basis? If not, why?**

Yes, although we suggest that the criteria for using amortised cost is extended based upon the business model of the entity. Where instruments are held for trading or are otherwise likely to be realised through sale then fair value is an appropriate valuation basis. Where an asset or liability is likely to be held and realised through cash-flows over time then we believe amortised cost is a more appropriate measurement basis. Such an approach would avoid many of the practical difficulties in defining basic loan features.

**Question 2 - Do you believe that the exposure draft proposes sufficient, operational guidance on the application of whether an instrument has 'basic loan features' and 'is managed on a contractual yield basis'? If not, why? What additional guidance would you propose and why?**

No, our understanding is that the current guidance would prevent mortgages (which are generally at a standard variable rate published by the issuer) and non-recourse financing arrangement being carried at amortised cost as they fail to satisfy the basic loan features criteria. We view this as an unintended consequence of the drafting process and would expect this to be easily addressed through revised guidance.

**Question 3 - Do you believe that other conditions would be more appropriate to identify which financial assets or financial liabilities should be measured at amortised cost? If so,**

(a) what alternative conditions would you propose? Why are those conditions more appropriate?

(b) if additional financial assets or financial liabilities would be measured at amortised cost using those conditions, what are those additional financial assets or financial liabilities? Why does measurement at amortised cost result in information that is more decision-useful than measurement at fair value?

(c) if financial assets or financial liabilities that the exposure draft would measure at amortised cost do not meet your proposed conditions, do you think that those financial assets or financial liabilities should be measured at fair value? If not, what measurement attribute is appropriate and why?

As previously discussed we believe that classification based on an entity's business model is going to result in more decision user information for readers of financial statements. In instances where an entity will realise the value of an asset over time through cash-flows we believe it is misleading to measure performance on the basis of movement in fair value – particularly as in many instances an entity has no practical ability or desire to recognise short term movements in value. Whilst we recognise that the fair value has a place we consider that the requirements of IAS 7 are an appropriate mechanism to disclose the fair value of assets and liabilities and ensure there is appropriate transparency of both measurement bases.

**Question 4 - (a) Do you agree that the embedded derivative requirements for a hybrid contract with a financial host should be eliminated? If not, please describe any alternative proposal and explain how it simplifies the accounting requirements and how it would improve the decision-usefulness of information about hybrid contracts?**

**(b) Do you agree with the proposed application of the proposed classification approach to contractually subordinated interests (ie tranches)? If not, what approach would you propose for such contractually subordinated interests? How is that approach consistent with the proposed classification approach? How would that approach simplify the accounting requirements and improve the decision usefulness of information about contractually subordinated interests?**

It is critical that the ability to bifurcate derivatives is retained as otherwise there is no mechanism to prevent an instrument with an embedded derivative of inconsequential value to be carried at amortised cost and we consider that the alternative of materiality threshold is impractical. As an example it is common to issue hybrid debt instruments at a floating interest rate (as fixed margin above an index interest rate) with a term that allows the term of the instrument to be extended where the share price of the issuer falls below a pre-determined level. Such a term is common and represents an embedded derivative which generally has negligible value at issuance. These instruments would otherwise qualify for valuation on an amortised cost basis but the current guidance would require them to be carried at fair value which would introduce significant earnings impacts based on movement in own name credit.

We also consider that classification based on contractually subordinated interests is a completely form based criteria without technical merit. For example we can see no basis why a AA rated tranche of a mortgage securitisation should be accounted for differently to a AA rated corporate bond given that the two instruments are effectively identical. This issue could be addressed through a business model based classification approach, which would also prevent the obvious structuring opportunities presented by the current wording of the requirements.

**Question 5 - Do you agree that entities should continue to be permitted to designate any financial asset or financial liability at fair value through profit or loss if such designation eliminates or significantly reduces an accounting mismatch? If not, why?**

Yes, we consider this to be a critical feature of a measurement model to allow an entity to accurately reflect economic reality and prevent asymmetrical accounting outcomes.

**Question 6 - Should the fair value option be allowed under any other circumstances? If so, under what other circumstances should it be allowed and why?**

Yes, we can see no reason why the fair value option should not be retained provided that there is clear disclosure of assets and liabilities that have been valued on this basis and the rationale for the accounting election is disclosed.

**Question 7 - Do you agree that reclassification should be prohibited? If not, in what circumstances do you believe reclassification is appropriate and why do such reclassifications provide understandable and useful information to users of financial statements? How would you account for such reclassifications, and why?**

No, we believe that it is important that the framework has sufficient flexibility to allow reclassification in limited circumstances, provided that there is clear disclosure around the nature, rationale and financial impact of any reclassification. If a business model approach is applied then it is important that this mechanism exists so that the accounting treatment continues to align to the business rationale when the business model changes.

**Question 8 - Do you believe that more decision-useful information about investments in equity instruments (and derivatives on those equity instruments) results if all such investments are measured at fair value? If not, why?**

No, as a fair value approach ignore the way in which the entity intends to realise the value of the equity investments and in many instances it is not possible to realise short term movements in values – frequently it is incompatible with the business model as we have articulated in our response to earlier questions. Our view is that many of the current concerns around the valuation of AFS equity investments is driven purely by the inability to reverse impairment in subsequent reporting period. For equity investments where there is a buy and hold strategy our view is that the most appropriate treatment is to recognise dividend income as income and recognised any gains when they have been realised. Otherwise we consider it appropriate to carry these investments at fair value with changes in fair value through equity, except for impairment which we can accept being measured at fair value **provided there is the ability to reverse any impairment** in future periods.

**Question 9 - Are there circumstances in which the benefits of improved decision-usefulness do not outweigh the costs of providing this information? What are those circumstances and why? In such circumstances, what impairment test would you require and why?**

Generally we are in a position to determine fair value however this provision seems to a sensible practical concession, particularly for smaller organisations. Impairment could be assessed as the lower of cost or net realisable value consistent with existing accounting provisions.

**Question 10 - Do you believe that presenting fair value changes (and dividends) for particular investments in equity instruments in other comprehensive income would improve financial reporting? If not, why?**

No, refer earlier comments in respect of the business model. Such an approach also continues the alarming trend of diminishing the significance of statutory profit as a performance measure and increasing the need to disclose a reconciliation between statutory profit and some form of underlying earnings.

**Question 11 - Do you agree that an entity should be permitted to present in other comprehensive income changes in the fair value (and dividends) of any investment in equity instruments (other than those that are held for trading), only if it elects to do so at initial recognition? If not, (a) how do you propose to identify those investments for which presentation in other comprehensive income is appropriate? Why? (b) should entities present changes in fair value in other comprehensive income only in the periods in which the investments in equity instruments meet the proposed identification principle in (a)? Why?**

No, refer earlier responses, in particular question 8.

**Question 12 - Do you agree with the additional disclosure requirements proposed for entities that apply the proposed IFRS before its mandated effective date? If not, what would you propose instead and why?**

We agree with the additional proposed disclosure requirements for early adoption.

**Question 13 - Do you agree with applying the proposals retrospectively and the related proposed transition guidance? If not, why? What transition guidance would you propose instead and why?**

We consider the requirement to apply the proposals retrospectively to be un-necessarily burdensome and would suggest that the impact on the comparative period could be effectively dealt with by way of disclosure. For those entities wishing to apply the proposal retrospectively we believe it is appropriate to provide this option provided that there is clear disclosure of the approach taken.