Australian Government
Australian Accounting Standards Board

Memorandum

To:	**AASB members**	**Date:**	14 May 2013
From:	**Christina Ng & Sue Lightfoot**	**Agenda Item:**	9.1 (M131)
Subject:	**Financial Instruments: Project Update**	**File:**	

Action

- Provide staff with a preliminary indication of the broad approach to take in developing the AASB's submission and the main themes to include, subject to comments from constituents, on the IASB's ED/2012/4 *Financial Instruments: Expected Credit Losses*.

- For information – receive an update on the IASB's project to replace IAS 39 *Financial Instruments: Recognition and Measurement* with IFRS 9 *Financial* Instruments, in particular on general hedge accounting.

Attachments

Agenda paper 9.2 – Issues paper: IASB proposals on ED/2013/3 *Financial Instruments: Expected Credit Losses* [to be mailed on 20 May 2013]

Agenda paper 9.3 – Notes on AASB Roundtables on ED/2013/3 [to be tabled]

Agenda paper 9.4 – Comment letter on ED 237 from Hayes Knight

Overview

Impairment

1 The AASB issued ED 237 *Financial Instruments: Expected Credit Losses* on 12 March 2013. ED 237 incorporates the IASB's ED/2013/3 *Financial Instruments: Expected Credit* Losses. Comments on ED 237 were due to the AASB on 10 May 2013. One submission had been received as at the date of this memo (Agenda paper 9.4) but we are expecting others in due course. Comments on ED/2013/3 are due to the IASB by 5 July 2013.

2 Board members have been provided with the following documents previously. (Board Members who would like to receive any of these documents again should contact Christina Ng at cng@aasb.gov.au) – although hyperlinks are provided below.

(a) AASB ED 237 *Financial Instruments: Expected Credit Losses*

(b) IASB ED/2013/3 *Financial Instruments: Expected Credit Losses*

(c) IASB Snapshot of ED/2013/3 *Financial Instruments: Expected Credit Losses*

(d) IASB Investor Perspectives article on ED/2013/3

(e) FASB Proposed Accounting Standards Update (ASU) *Financial Instruments: Credit Losses* (subtopic 825-15) [note that the comment due date has been extended to 31 May 2013].

(f) FASB Frequently Asked Questions on its Proposed ASU

(g) FASB In Focus on its Proposed ASU

(h) Ernst and Young 'Practical Matters' dated 24 January 2013

(i) PricewaterhouseCoopers comparison between the IASB and FASB proposals, dated 18 April 2013

(j) KPMG 'Defining Issues' dated January 2013

(k) Deloitte 'Heads Up', summary of FASB Proposals, dated 21 December 2012

3 The model in ED/2013/3 is the IASB's third proposed replacement for the 'incurred loss' impairment requirements in IAS 39.

4 The proposed model would apply to:

(a) financial assets measured at amortised cost, including trade receivables;

(b) financial assets that are mandatorily measured at fair value through other comprehensive income (if such a category is introduced, as currently has been proposed in ED/2012/4 *Classification and Measurement: Limited Amendments to IFRS 9* which was open for comment to the IASB until 28 March 2013) and incorporated into AASB ED 230[1] *Classification and Measurement: Limited Amendments to AASB 9*;

(c) loan commitments when there is a contractual obligation to extend credit;

(d) financial guarantees in the scope of IFRS 9 that are not at fair value through profit or loss; and

(e) lease receivables.

5 The key proposals in ED/2013/3 are as follows:

(a) to require recognition of credit losses earlier than the IAS 39 'incurred loss' model would allow. Loss recognition would not be dependent on the entity first identifying a credit loss event, which is a current requirement under IAS 39;

1 The AASB's submission on ED/2012/4 is available on the AASB website [here]. It expressed the AASB's broad support for introducing a mandatory fair value through other comprehensive income (FVOCI) category for financial instruments, but also expressed the AASB's concerns about the increase in complexity that would be introduced by the new category, and concerns about the inconsistency between the new category, which would involve recycling of amounts to profit or loss, with the FVOCI designation in IFRS 9 for equity securities, which does not involve recycling; without a conceptual basis for the difference.

(b) to require an entity to distinguish between:

(i) financial instruments that have not deteriorated significantly in credit quality since initial recognition or that have low credit risk (for example, which are 'investment grade') at the reporting date. For these financial assets, lifetime credit losses would be recognised associated with default events possible over the next 12 months; and

(ii) financial instruments that have deteriorated significantly in credit quality since initial recognition (unless they have low credit risk at the reporting date). For these financial assets, lifetime expected credit losses are recognised in respect of default events possible over their lifetimes; and

(c) to require an entity to measure expected credit losses using historical, current and future estimates of expected shortfalls in cash flows as at the reporting date.

6 The AASB will hold roundtable discussions on ED 237 in Melbourne (21 May 2013) and Sydney (24 May 2013), and separately, AASB staff will meet with mainly banking industry constituents between 13-24 May to discuss ED 237.

7 AASB staff will:

(a) provide an issues paper on the IASB's proposals, including consideration of its proposals in comparison with the FASB's proposals by 20 May 2013[2]; and

(b) table any further comment letters received on ED 237 and comments received at the AASB roundtables at the May 2013 AASB meeting.

8 As the forthcoming May 2013 meeting is the last AASB meeting scheduled before the IASB's due date for comments, AASB staff suggest that the AASB submission to the IASB on ED/2013/3 be finalised out-of-session through the Impairment Sub-committee. Staff intend to include comments on the FASB proposals in the submission to the IASB. As the IASB and FASB will consider the feedback on each other proposals it is not intended that a separate comment letter would be submitted to the FASB.

General Hedge Accounting

9 In its April 2013 meeting, the IASB discussed general hedge accounting and finalised its redeliberations on the review draft on general hedge accounting, which the IASB had published on its website in September 2012.

10 The IASB decided to provide an accounting policy choice for entities to either apply hedge accounting requirements of IFRS 9 or retain the IAS 39 requirements. For entities that choose to apply the hedge accounting requirements of IFRS 9, they could do so, but could elect to continue to follow IAS 39 for portfolio interest rate fair value hedge accounting relationships.

11 The IASB confirmed that, even if an entity continues to apply IAS 39 hedge accounting requirements, the new hedge accounting disclosures in IFRS 9 would apply, even if IAS 39 hedge accounting is elected as an accounting policy choice.

2 The mailout of this issues paper has been delayed a week to allow time for staff to be further informed through outreach to particular constituents scheduled during that week.

12 The IASB requirements on general hedge accounting are expected to be issued in either Q2 or Q3 of 2013. Once that has occurred staff plan on following the normal process of incorporating those new requirements into Australian Accounting Standards. Staff are not aware of any not-for-profit or public sector specific issues, and therefore we do not envisage a significant delay in preparing ballot drafts of relevant standards[3]. Confirmation has been received from the Office of Best Practice Regulation that a Regulatory Impact Statement will not be required.

3 In March 2011 the AASB issued a Tier 2 Supplement to ED 208 *Hedge Accounting* (Proposed Amendments to AASB 7), which is available on the AASB website [here]. In the Tier 2 Supplement it was proposed that Tier 2 entities are exempt from a number of the disclosure requirements. It will be necessary to compare the final disclosures with what was proposed in ED and determine whether any of the Tier 2 proposals would need to be modified, and what subsequent due process might be warranted. Staff do not expect the final disclosures to be significantly different from what was proposed.