Australian Government
Australian Accounting Standards Board

Memorandum

To:	**AASB members**	**Date:**	13 May 2014
From:	**Sue Lightfoot**	**Agenda Item:**	14.1 (M138)
Subject:	**Financial Instruments:**	**File:**	

Action

- Receive an update on the IASB's *Financial Instruments* project;
- Receive an update on the IASB's *Accounting for Dynamic Risk Management* project, including a summary the proposed outreach activities on ITC 31.
- AASB members to provide any preliminary views on Invitations to Comment (ITC 31) *Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging* for discussion at the June 2014 Accounting Standards Advisory Forum (ASAF) meeting[1].

Attachments

Agenda paper 14.2 – IASB Webinar Slides *Accounting for Dynamic Risk Management* (29 April 2014)

Agenda paper 14.3 – June 2014 ASAF Meeting Agenda Paper 5A *Macro Hedging*

Background

As at the date of this memo, the IASB work-plan indicates that a final version IFRS 9 *Financial Instruments* is expected to be issued in Q2 of 2014. That version would incorporate the requirements on impairment and make the remaining limited amendments to classification and measurement. The expected mandatory application date of IFRS 9 is for annual periods beginning on or after 1 January 2018.

At the May 2012 IASB meeting it was tentatively agreed that accounting for macro hedging would be decoupled from IFRS 9 *Financial Instruments*.

On 5 May 2014 the AASB issued ITC 31. ITC 31 incorporates the IASB's Discussion Paper (DP) of the same name. A copy of ITC 31 can be located on the AASB website here.

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1 AASB Staff appreciate that, by the time of the May Board meeting, many members will not have had a chance to become familiar with ITC 31, and staff plan a further education session (probably at the July meeting). However, the topic is on the June ASAF meeting, and any early comments would be most welcome.

Overview of ITC 31

ITC 31 seeks initial views on the IASB's preliminary views on an approach to accounting for an entity's dynamic risk management activities, being the 'portfolio revaluation approach' (PRA). The purpose of ITC is to obtain more information to understand the costs and benefits of the PRA including whether, and the extent to which, the risk management perspective can and should be reflected in the financial statements.

The IASB is particularly interested in whether the information provided by the PRA would be useful to users of financial statements, whether the PRA faithfully represents the dynamic risk management perspective in the view of preparers and to understand the operational effects of the PRA. The feedback from the DP will help the IASB determine the next steps in the accounting for dynamic risk management.

Comments to the AASB are due by 19 September 2014 and comments to the IASB are due by 17 October 2014.

The IASB has also provided on its website a Snapshot on the DP and an article by IASB Board Member, Stephen Cooper, *Dynamic risk management—accounting in an age of complexity* on its website.

The IASB also ran two webinars on 29 April 2014 concerning its Discussion Paper. The slides accompanying the webinars are attached as Agenda paper 14.2.

Accounting for Dynamic Risk Management Project

The objective of the *Accounting for Dynamic Risk Management* project is to develop an approach to better reflect entities' dynamic risk management activities in their financial statements and to enhance the usefulness of the financial information to help users of financial statements to better understand such activities.

The IASB began its deliberations on the project in September 2010, in response to the difficulties associated with applying existing hedge accounting requirements to a dynamically managed portfolio with continuous or frequent changes in the risk positions that are being hedged. The project was initially part of the broader project to replace IAS 39 *Financial Instruments: Recognition and Measurement* with IFRS 9 *Financial Instruments*. However, the IASB realised that the development of a new accounting approach for dynamic risk management would take time and could not be achieved within the time line for completing IFRS 9. Consequently, in May 2012 the IASB decided to continue finalising IFRS 9 as planned while developing an accounting approach for dynamic risk management as a separate project.

Portfolio Revaluation Approach

The IASB originally sought to better reflect risk management in the accounting by amending IAS 39 to incorporate fair value hedge accounting for a portfolio hedge of interest rate risk. However, there are a broader range of risks that might be hedged on a portfolio basis. Furthermore, entities have found the IAS 39 amendments difficult to apply in practice to dynamically managed portfolios.

The DP outlines a new possible approach, the PRA, to accounting for an entity's dynamic risk management activities. Under the PRA, an entity would adjust exposures that are dynamically risk managed to reflect the effect of changes in value that are arising from the risk that is being managed. For the managed exposures, only the managed risk component is revalued to fair value, with any gains or losses recognised in profit or loss – the managed exposures as a whole are not measured at fair value.

Dynamic risk management of interest rate risk, particularly as managed by banks, is used throughout the DP for illustrative purposes. However, the approach considered in the DP is intended to be applicable to the management of risks arising from both financial and non-financial items, when those risks are dynamically managed. The IASB is using the DP as a basis for learning more about how the approach could be applied to other risks, and what, if any, special considerations are necessary for risks other than interest rate risk.

The DP considers whether the PRA would provide useful information, and whether the operational issues of existing hedge accounting requirements are addressed. In the PRA, for accounting purposes, the net open risk position(s) of dynamically managed portfolio(s) is identified and revalued for changes in the managed risk (for example, interest rate risk).

The advantages of this approach noted in the DP are:

(a) the presentation of the revalued net open risk position(s) and associated gains or losses, combined with explanatory disclosures enhance transparency regarding the actual business risks and risk management activities;

(b) a more faithful representation of economic volatility in profit or loss; and

(c) data and systems already used for risk management purposes are more likely to produce relevant information for accounting purposes.

The preliminary views in the DP are potentially relevant to all entities that manage risks in open portfolios on a dynamic basis. The PRA presented in the DP is not intended to be limited to banks or interest rate risk. Ultimately, if the preliminary views in the DP became a final Standard, a key element in determining how entities would be affected would be the decision on whether the model is mandatory or optional.

In addition, the outcome of the project would replace the current ‘fair value hedge accounting for a portfolio hedge of interest rate risk’ in IAS 39. Consequently, entities using those accounting requirements would be impacted if the preliminary views in the DP become a final Standard.

AASB input for June 2014 ASAF Meeting

The next IASB Accounting Standards Advisory Forum (ASAF) is to be held on 2-3 June 2013 in London. The agenda for the meeting indicates that ASAF members will be asked for initial views and be given an opportunity to have answered any questions arising from the DP.

The eight specific topics the IASB would like input on are as follows:

1. Assessing the need for an approach to represent dynamic risk management;
2. Behaviouralisation;
3. Core demand deposits;
4. Revaluation of the managed exposures;
5. Transfer pricing transactions;

6. Scope of the application of the Portfolio Revaluation Approach (PRA);

7. Applying the PRA to other risks; and

8. PRA through OCI.

Agenda Paper 5A of the June ASAF meeting is attached as Agenda Paper 14.3. That Agenda Paper includes a brief description of the topics for which initial views are requested. At this stage, AASB staff are seeking only preliminary Board views for the purposes of the ASAF discussion.

Questions to Board members:

1 Do Board members have any initial views in relation to the eight specific topics the IASB would like input on for the June ASAF meeting?

2 Are there any additional questions in relation to ITC 31 that Board members would like AASB staff to raise with the IASB at the June ASAF meeting?

Proposed outreach activities

In addition to seeking formal submissions, AASB staff propose conducting targeted outreach with Australian constituents to seek views on ITC 31. The risk management activities to be targeted are likely to be from the following industries:

- Banking
- Insurance
- Extractive industries
- Electricity suppliers

At this stage, AASB staff do not propose holding public roundtables on the basis that the population of entities impacted by the proposals is limited. In addition, given the potentially commercially sensitive nature of the risk management activities in question, AASB staff expect that higher quality feedback is more likely to obtained from individual meetings.

AASB staff also plan to dial-in to an IASB/Hong Kong Institute of Chartered Public Accountants (HKICPA) roundtable on the DP to be held in Hong Kong on 29 May 2014.

Question 3 to Board members:

Do Board members agree with the AASB staff proposals for outreach activities on ITC 31?