

**Issues and key comments on the
 IASB Request for Comment on the FASB ED**

1 Classification and measurement of financial assets

IASB – IFRS 9	FASB ED
(a) Fair value through profit or loss (FVTPL) – if the amortised cost criteria are not met	(a) Fair value through net income (FVTNI) – default category for all financial assets
(b) Fair value through other comprehensive income (FVTOCI) – optional initial designation for: <ul style="list-style-type: none"> • equity instruments not held for trading. (Also see Issue 3 Classification and measurement of equity instruments) 	(b) FVTOCI – optional if: <ul style="list-style-type: none"> • the investment is to be returned to the creditor at maturity or settlement; • the additional contractual cash flows are to be paid to the creditor periodically or at maturity; • prepayment is not permitted so that the creditor would not recover substantially all its investment; • the business strategy is to hold the financial asset to collect contractual cash flows; and • there is no embedded derivative that would require bifurcation. Reclassify other comprehensive income (OCI) amounts to net income upon sale, settlement or impairment
(c) Amortised cost – required if: <ul style="list-style-type: none"> • the business model is to hold the financial asset to collect contractual cash flows; and • the cash flows characteristics consists of principal and interest on principal; 	(c) Amortised cost – optional if short-term receivable meets the FVTOCI criteria and is: <ul style="list-style-type: none"> • part of the normal course of business; and • due in one year or less;
(d) Financial assets designated at fair value or fair value option (FVO) financial assets – optional if: <ul style="list-style-type: none"> • fair value designation eliminates or significantly reduces accounting mismatch. 	Nil – since default category is FVTNI

Staff comments

1.1 Staff consider that requiring the measurement of all financial assets at fair value is desirable for the sake of overall consistency, and because fair values generally provide more information value than cost amounts. However, while we would support requiring

Issues and key comments on the IASB Request for Comment on the FASB ED

all financial assets to be at fair value in the longer term, it is probably not feasible as a basis for achieving one set of global requirements on financial instruments at this time. Furthermore, staff consider that the FASB's decision to propose FVTNI as the default classification has not been justified sufficiently in its ED. As a result, staff prefer the mixed measurement categories under IFRS 9 and do not support the FASB's proposal for fair valuing all financial assets as a basis for convergence. Staff note that support for having mixed measurement categories is broadly consistent with the Financial Stability Board's views that are "... supportive of standards that would not expand the use of fair value in relation to the lending activities of financial intermediaries" (Report of the FSB to G20 Leaders, *Overview of Progress in the Implementation of the G20 Recommendations for Strengthening Financial Stability*, 18 June 2010, page 8).

- 1.2 Staff also consider that, in view of the aim of simplifying the accounting for financial instruments, the FASB's proposed classification and measurement as between FVTNI and FVTOCI is relatively more complex than the FVTPL and amortised cost distinction under IFRS 9. This is because staff are of the view that the basis for the FASB's classification is not clear, and that the constituent feedback so far on the IFRS 9 classification criteria (based on the entity's business model in managing its financial assets) indicates it will be relatively simple to implement.
- 1.3 Staff consider that the IFRS 9 requirements provide a reasonable balance between moving towards fair value measurement for financial assets and restricting amortised cost to a readily identifiable category of loans and trade receivables. Staff also consider that IFRS 9 provides a sound basis for achieving convergence among most jurisdictions for financial asset accounting. Accordingly, staff do not support the FASB's proposals for financial asset classification and measurement.

Question 1

Does the Board agree with the AASB staff comments?

**Issues and key comments on the
IASB Request for Comment on the FASB ED**

2 Classification and measurement of financial liabilities

IASB – ED/2010/4¹	FASB ED
<p>(a) Fair value through profit or loss (FVTPL) – if fail the amortised cost criteria. Given that the IASB is proposing little change from IAS 39 for financial liabilities, the outcome of the proposals would be that most financial liabilities would remain at amortised cost.</p>	<p>(a) Fair value through net income (FVTNI) – default category for all financial liabilities. Total fair value change is recognised in profit or loss and fair value changes pertaining to the entity’s own credit risk is presented as a separate line item. [Also see (b) below]</p>
<p>(b) Nil – see (d) below.</p>	<p>(b) FVTOCI – optional if:</p> <ul style="list-style-type: none"> • the investment is to be returned to the creditor at maturity or settlement; • the additional contractual cash flows are to be paid to the creditor periodically or at maturity; • prepayment is not permitted so that the creditor would not recover substantially all its investment; • the business strategy is to hold the financial liability to pay contractual cash flows; and • there is no embedded derivative that would require bifurcation. <p>Total fair value change is recognised in OCI and fair value changes pertaining to the entity’s own credit risk is presented as a separate line item.</p> <p>Reclassify OCI amounts to net income upon sale, settlement or impairment.</p>

¹ IASB ED/2010/4 *Fair Value Option for Financial Liabilities*

**Issues and key comments on the
IASB Request for Comment on the FASB ED**

IASB – ED/2010/4 ¹	FASB ED
<p>(c) Amortised cost – required if the financial liabilities:</p> <ul style="list-style-type: none"> • are not held for trading; and • are not designated at fair value. 	<p>(c) Amortised cost – optional if:</p> <ul style="list-style-type: none"> • the short-term payable meets the FVTOCI criteria and is: <ul style="list-style-type: none"> ○ part of the normal course of business; and ○ due in, or less than, one year; • the financial liability meets the FVTOCI criteria and is: <ul style="list-style-type: none"> ○ contractually linked to amortised cost asset; or ○ a liability in operating segment or consolidated entity with less than 50% assets measured at fair value
<p>(d) Fair value designated financial liabilities or fair value option (FVO) financial liabilities – optional if:</p> <ul style="list-style-type: none"> • fair value designation eliminates or significantly reduces accounting mismatch; or • the entity manages and evaluates group of instruments on fair value basis; or • the financial liability contains embedded derivatives that require bifurcation. <p>FVO election is irrevocable.</p> <p>Total fair value change is recognised in profit or loss and fair value changes pertaining to the entity’s own credit risk is reclassified to OCI. (Also compare against FASB ED (a) and (b))</p>	<p>(d) Nil – since default category is FVTNI.</p>
<p>(e) Demand deposit liabilities are not specifically addressed under IFRS 9, but presumably the demand ‘deposit floor’ will be retained.</p>	<p>(e) Core demand deposit liabilities:</p> <ul style="list-style-type: none"> • are measured at present value of average deposit balance discounted over the implied maturity at a rate equal to the difference between the alternative funding rate and all-in-cost-to-service rate; and • that meet the FVTOCI criteria are provided with an option to recognise its present value changes in OCI.

Issues and key comments on the IASB Request for Comment on the FASB ED

Staff comments

- 2.1 Staff are of the view that the FASB's proposed classification and measurement of financial liabilities could be simplified further and that the justification for fair valuing all financial liabilities could be better articulated as mentioned in paragraphs 1.1 and 1.2 above.
- 2.2 Staff note that the FASB's classification and measurement proposals for financial assets are consistent with their proposals for financial liabilities, whereas there is asymmetry between the IFRS 9 classification and measurement approach to financial assets (that is in accordance with the entity's business model and cash flow characteristics) and the proposals to essentially retain the IAS 39 financial liabilities classification and measurement approach.
- 2.3 Staff consider that the IASB's asymmetrical approaches would be a divergence from the aim of simplifying the accounting of financial instruments and for the purpose of convergence with the FASB. Accordingly, staff recommend that the IASB consider revising its proposals to achieve consistency in the classification and measurement criteria for both financial assets and financial liabilities. Although the FASB proposals offer a symmetrical approach, given that staff consider the FASB proposals for financial assets would not be a sound basis for achieving convergence, we cannot support the FASB's financial liabilities proposals either.
- 2.4 Staff also note that the proposed accounting treatment for financial liabilities where changes in fair value relates to the entity's own credit risk is inconsistent between IASB ED/2010/4 and FASB ED. Under ED/2010/4, changes in the entity's own credit risk would be reclassified from the profit or loss to OCI, whereas the FASB proposes that changes in the entity's own credit risk would be presented as a separate line item within profit or loss, or OCI, depending on the classification of the financial liability.
- 2.5 The AASB was highly critical of the IASB's ED/2010/4 proposal regarding own credit risk because it would effectively introduce another measurement model into IFRSs. Staff consider that the existing disclosure requirement in IFRS 7 regarding movements relating to changes in own credit risk is sufficient, and note that the FASB presentation proposal is closest to this approach. Accordingly, staff support the FASB's proposal as it remains faithful to the proposed measurement attribute, that is, FVTNI or FVTOCI. Furthermore, the FASB proposal is relatively simple compared with the IASB proposal

Issues and key comments on the IASB Request for Comment on the FASB ED

in terms of the presentation of own credit risk within the statement of comprehensive income. Staff also note that, under the FASB ED, the bifurcation of fair value changes relating to the entity's own credit risk depends on the significance of the change in own credit risk and that this seems likely to result in fewer cases of bifurcation compared with the IASB proposals, which would also be a welcome simplification.

- 2.6 Staff consider there is merit in the FASB's proposed accounting for demand deposit liabilities, on the basis that it moves these instruments closer to a fair value basis and could be considered to be consistent with the IFRS 9 model for distinguishing between financial assets measured at that fair value and those at amortised cost. That is because many constituents have indicated that demand deposits are a key source of value for many financial institutions and, if a financial institution leverages off its demand deposits, this is a strong indication that the fair value of those deposits is a key driver for its business model.
- 2.7 However, staff also have concerns with the FASB proposal in relation to demand deposits because of the possible complications in determining the 'core' amount of deposits that can be present valued and because it may not be a treatment around which other jurisdictions would want to converge.
- 2.8 On balance, staff consider that the IASB should be encouraged to consider the FASB's direction in proposing the re-measurement of demand deposits, but that at this stage the AASB should not support it unless there are indications that jurisdictions applying IFRSs would be willing to adopt the proposal.

Question 2

Does the Board agree with the AASB staff comments?

Specifically, what are the Board's views on accounting for demand deposit liabilities in paragraph 2.4?

Issues and key comments on the IASB Request for Comment on the FASB ED

3 Classification and measurement of equity investments

IASB	FASB ED
<p>(a) Under IFRS 9, equity investments are:</p> <ul style="list-style-type: none"> • carried at FVTPL; or • carried at FVTOCI if not held for trading. <p>Equity instruments can be irrecoverably designated at inception at FVTOCI, in which case:</p> <ul style="list-style-type: none"> • unrealised and realised gains and losses are recognised in OCI; • dividend income is recognised in profit or loss, unless dividend represents the recovery of part of the investment's cost; • reclassification into profit or loss is not permitted upon sale; • no impairment is recognised as there is no recycling. 	<p>(a) Equity investments are:</p> <ul style="list-style-type: none"> • carried at FVTNI. <p>Redeemable investments are carried at redemption value, with changes in redemption value recognised in net income.</p>

Staff comments

- 3.1 Staff acknowledge that there are equity investments that are not held for trading purposes and consequently, "... presenting fair value gains and losses in profit or loss for some equity investments may not be indicative of the performance of the entity, particularly if the entity holds those equity instruments for non-contractual benefits, rather than primarily for increases in the value of the investment." (IFRS 9 paragraph BC83). Based on recent constituent liaison, the treatment of equity instruments under IFRS 9 is considered a sound basis for convergence among most jurisdictions. Accordingly, staff support the IASB view that equity investments that are not held for trading should be provided with an election to FVTPL or FVTOCI. This is also consistent with earlier comments regarding using the entity's business model as a basis for the entity to assess the classification and measurement of equity instruments.
- 3.2 In addition, staff consider that when a measurement attribute (FVTPL or FVTOCI) has been elected, all movements (gains or losses and returns) from the instrument should be held in profit or loss, or other comprehensive income, to remain faithful to the concept of FVTPL or FVTOCI as part of simplifying the accounting for financial instruments. However, staff note that the IASB has diverged from the FVTOCI measurement model

Issues and key comments on the IASB Request for Comment on the FASB ED

by requiring dividend income from equity investments that are not held for trading to be recognised in profit or loss. In this respect, staff recommends that the IASB reconsider its basis for recognising dividend income in profit or loss.

Question 3

Does the Board agree with the AASB staff comments?

4 Accounting for hybrid instruments

IASB	FASB ED
(a) Under IFRS 9, if embedded derivatives are not closely related to the financial host asset and are likely to fail the amortised cost criteria, the asset is measured in its entirety at FVTPL.	(a) Financial host assets with embedded derivatives: <ul style="list-style-type: none"> • that must be bifurcated and accounted for separately as a derivative under existing guidance², are measured in their entirety at FVTNI; or • that does not require bifurcation under existing guidance and that meet the FVTOCI criteria are permitted to be measured at FVTOCI.
(b) Under ED/2010/4, if embedded derivatives are not closely related to the financial host contract, the embedded derivative would be bifurcated from the host.	(b) Financial liabilities with embedded derivatives: <ul style="list-style-type: none"> • that must be bifurcated and accounted for separately as a derivative under existing guidance², are measured in their entirety at FVTNI; or • that does not require bifurcation under existing guidance and that meet the FVTOCI criteria are permitted to be measured at FVTOCI.

Staff comments

4.1 Staff note that the FASB has been consistent with the treatment of hybrid assets and hybrid liabilities by eliminating the current bifurcation requirements for both asset and

2 Embedded derivatives are bifurcated from the financial host contract, under existing guidance, if: (1) the economic characteristics and risks of the embedded feature are not clearly and closely related to the economic characteristics and risks of the host contract; and (2) a stand-alone contract with the same terms as the embedded derivative feature would meet the definition of a derivative inside the scope of derivative accounting under FASB ASC Subtopic 815 Derivatives and Hedging. (FASB ASC Subtopic 815 paragraph 815-15-25-1)

Issues and key comments on the IASB Request for Comment on the FASB ED

liability hosts if particular criteria are met (FASB ASC Subtopic 815 paragraph 815-15-25-1). Staff consider that this approach is consistent with having a simpler measurement framework for financial instruments. On the other hand, staff are concerned by the approach adopted by the IASB for developing asymmetrical accounting requirements for embedded derivatives in asset and liability hosts and notes that the IASB has not provided sufficient justification for this inconsistency. One concern is that the borrower of a loan (with an embedded derivative that is not closely related) would be required to bifurcate and measure the loan payable at amortised cost, whereas the lender of that same loan would be required to fair value the loan asset in its entirety.

- 4.2 One of the reasons for the IASB's approach to hybrid financial assets in IFRS 9 is the relative simplicity of not having to bifurcate (IFRS 9 paragraph BC59). Accordingly, it is not clear to AASB staff why the same approach has not been adopted for financial liabilities and we believe that the lack of symmetry would add complexity to the accounting for financial instruments, particularly from the perspective of users trying to compare the reported outcomes of transactions between counterparties. Consequently, staff support the FASB's consistent approach in requiring bifurcation if particular criteria are met for both financial assets and financial liabilities.

Question 4

Does the Board agree with the AASB staff comments?

Issues and key comments on the IASB Request for Comment on the FASB ED

5 Impairment of financial assets

IASB – ED/2009/12 ³	FASB ED
<p>(a) Impairment assessment is based on an expected loss model using the expected cash flow methodology. That is, credit losses are assessed at initial recognition of assets based on expected cash flows over the lives of the assets and the credit losses are spread over those lives through lower revenue recognition. Subsequent changes from initial credit loss assessments are recognised immediately in profit or loss.</p> <p>No trigger or loss event is required before impairment is recognised.</p>	<p>(a) Impairment assessment is based on all available information relating to past events and existing conditions. Credit loss is recognised immediately in profit or loss.</p> <p>It is no longer necessary to demonstrate that it is probable that the entity will be unable to collect all contractual cash flows before impairment is recognised.</p> <p>The FASB proposals equates to an incurred but not reported loss model</p>
<p>(b) Effective interest rate (EIR) equates the present value of expected cash flows net of credit losses over the life of the instrument (adjusted for net deferred loan fees or costs or discounts) with transaction price.</p>	<p>(b) EIR equates the present value of contractual cash flows (adjusted for net deferred loan fees or costs or discounts) with transaction price.</p>
<p>(c) Interest income is recognised by applying the EIR net of expected losses, to the carrying amount.</p>	<p>(c) Interest income is recognised by applying the contractual EIR to the carrying amount net of accumulated allowance for credit losses.</p>

Staff comments

- 5.1 Staff note that as part of the FCAG and G20 recommendations, both the IASB and FASB have proposed impairment models that would require the earlier incorporation of a greater range of information about the credit quality of financial assets than is currently allowed under IAS 39. Therefore, both the IASB's and FASB's proposals would generally be expected to result in losses being recognised earlier than currently permitted under IAS 39.
- 5.2 The AASB was highly critical of the IASB's proposals regarding its expected loss model because it would involve two different impairment approaches (initial and subsequent), departs from a transaction based approach and would corrupt the recognition of revenue that would be expected to flow from financial assets in a cost model.

3 IASB ED/2009/12 *Financial Instruments: Amortised Cost and Impairment*

**Issues and key comments on the
IASB Request for Comment on the FASB ED**

- 5.3 Staff consider that the FASB's proposed impairment model, although proposed in a fair value context, could be usefully applied in an amortised cost context and would bring forward loss recognition as recommended by the G20 and the FCAG without the complexity of the IASB's proposed model.
- 5.4 Accordingly, staff consider that the FASB's impairment model proposals would form a suitable basis for convergence and would involve fewer transition issues for entities moving from the existing IAS 39 approach to impairment.

Question 5

Does the Board agree with the AASB staff comments?