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Sir David Tweedie
Chairman
International Accounting Standards Board
30 Canon Street
London EC4M 6 XH

Submitted electronically through the IASB Internet site (www.iasb.org)

Dear Sir David

EXPOSURE DRAFT ED/2009/3: DERECOGNITION

Thank you for the opportunity to provide comments on this Exposure Draft.

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.

General comment

We support the IASB's agenda of reducing complexity in accounting for financial instruments. In our view, this can be achieved by means of a comprehensive principles-based standard founded on robust concepts that addresses the many concerns relating to the current IAS 39 "Financial Instruments: Recognition and Measurement" in the medium term, with targeted alterations to IAS 39 in the short-term aiming at alleviating the most pressing anomalies.

Accordingly, we are concerned about the current method of delivery of changes. We are aware that the IASB made a conscious decision to proceed with this ED in response to the global financial crisis. However we draw attention to:

- For financial institutions, specifically, multiple patches or separate revisions in different areas will result in significant time and effort required to modify systems and processes for financial reporting purposes and tax over time rather than in a single effort.

- Financial institutions operate in a heavily regulated sector. Entities require significant lead time to discuss with the regulators and address regulatory implications of changes.

- In relation to the Derecognition ED, we are not confident that the existing model needs replacement to start with and it certainly should not be a matter of priority. If considered necessary, it would be appropriately addressed as part of the overall IAS 39 revision project, not a separate exercise. In our view, derecognition criteria in IAS 39 did not result in inappropriate reporting or contributed to the current economic situation.

The Proposed Amendments

The control notion in the Proposed Amendments will not, in our view, consistently result in a true and fair presentation of financial position as far as transfers of financial assets are involved.

The IFRS Framework currently defines an *asset* as a *resource* controlled by the entity *from which future economic benefits* are expected to *flow to the entity* [emphasis added]. It is to draw a coherent link between the characteristics of an asset, and the ability of the entity to transfer the original asset. The ability to *direct future cash flow arising from a contractual relationship* is probably where control resides, leading to identification of the asset. The Alternative Approach published in the ED, in our view, is better aligned with this view.

We tend to agree with the Board members supporting the Alternative Approach, that financial contracts comprise cash flows that can be unbundled and rebundled. However, it is difficult to comment on the Alternative Approach conclusively given the incompleteness of the discussion in the ED. The IASB needs to develop a solid conceptual basis of what constitutes a unit of account as far as financial instruments are concerned and from that basis develop a new derecognition model.

In our view, the current model proved to be operational. The ED suggests that it proposes a simpler model which has only one step - control test – which has primacy. We are concerned that the underpinning "readily obtainable" criterion is quite subjective and when combined with the "continuing involvement" filter and the supplementary test of the "practical ability" of the transferee to use the asset, the Proposed Approach introduces the level of complexity similar to the current model.

In summary, we are unconvinced that the model proposed in the ED will result in an improvement in financial reporting of transfer arrangements. Meanwhile, it will require certain operational and system changes. Accordingly, we do not support this proposal.

The above documents our fundamental position. We have also taken the opportunity to provide detailed comments on questions raised in the ED.

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

Yours sincerely

SHANE BUGGLE
Group General Manager Finance

Copy: Australian Accounting Standards Board (AASB)

Question 1 – Assessment of 'the Asset' and 'continuing involvement' at reporting entity level

Do you agree that the determination of the item (ie the Asset) to be evaluated for derecognition and the assessment of continuing involvement should be made at the level of the reporting entity? If not, why? What would you propose instead and why?

Agree.

Question 2 – Determination of 'the Asset' to be assessed for derecognition

Do you agree with the criteria proposed in paragraph 16A for what qualifies as the item (ie the Asset) to be assessed for derecognition. If not, why? What criteria would you propose instead and why? **(Note: The criteria proposed in paragraph 16A are the same as those in IAS 39.)**

The proposed criteria of what could qualify for a derecognition, which are the same as in the current standard, are merely a set of rules stating that an entity may derecognise an asset as a whole, or a part of it provided this part is either specifically identified cash flows or a proportionate share of the cash flow from the asset. Neither the current model, nor the Proposed Approach lay down a clear conceptual basis for what constitutes an asset/unit of account as far as financial instruments are involved.

The Framework presently defines an asset as a resource controlled by the entity from which future economic benefits are expected to flow to the entity.

The current and proposed derecognition models suggest that the cash flows from a financial contract could be split, and therefore a part or portion of the original asset can be derecognised.

Ordinarily there is only one recipient of cash flows from a financial contract who is in a position to obtain (control) future economic benefits from this contract. The ability to *direct future cash flow arising from a contractual relationship* is probably where control resides, which should lead to identification of the asset. The practical implication of this is that only the original asset in its entirety should be considered for derecognition. When entering into a transfer arrangement, depending on the legal form, the entity might modify the nature of the original asset. Where this modification is significant, this should be reflected by de-recognising the original, and recognising a new asset.

The Alternative Approach has merit as it is better aligned with this view (although we cannot comment conclusively given the incompleteness of its discussion).

Question 3 – Definition of 'transfer'

Do you agree with the definition of a transfer proposed in paragraph 9? If not, why? How would you propose to amend the definition instead and why?

We support the proposed definition of what constitutes a "transfer". This allows for a broader inclusion of transaction for derecognition considerations, irrespective of their form.

Question 4 – Determination of 'continuing involvement'

Do you agree with the 'continuing involvement' filter proposed in paragraph 17A(b), and also the exceptions made to 'continuing involvement' in paragraph 18A? If not, why? What would you propose instead and why?

Our interpretation is that the proposed "continuing involvement" filter is laid over the "control" test. The outcome of this, as the dissenting Board members note, is that although the Proposed Approach purports to be based on control, it really follows a risk and rewards rationale which is overlaid with a control notion. We agree with their view that therefore it combines two approaches to derecognition, which we do not support. See also our responses to Question 2.

From the practical perspective, following from above, as the Proposed Approach attempts to accommodate for a two-tier test, it is likely to result in application difficulties and inconsistencies.

On this basis, we do not see benefits in replacing the current model which at present is well understood and tested.

(In regard to the second part of the question, we agree in principle that the exceptions listed in paragraph 18A should not constitute continuing involvement.)

Question 5 – 'Practical ability to transfer for own benefit' test

Do you agree with the proposed 'practical ability to transfer' derecognition test in paragraph 17A(c)? If not, why? What would you propose instead, and why?

(Note: Other than the 'for the transferee's own benefit' supplement, the 'practical ability to transfer' test proposed in paragraph 17A(c) is the same as the control test in IAS 39.)

Do you agree with the 'for the transferee's own benefit' test proposed as part of the 'practical ability to transfer' test in paragraph 17A(c)? If not, why? What would you propose instead, and why?

No, we do not agree. Where the current derecognition model is proposed to be replaced by a single test of control which has primacy, this control test should be very carefully designed to result in a consistent outcome. The way it is currently formulated may result in a curious control-based model.

We are concerned that the test requires considering attributes of an asset that are not identified elsewhere, including the Framework - specifically the practical ability of the transferee to do something and a presumption that ability to sell is the only means of controlling the financial asset or consuming the economic benefits. Further, the Proposed Approach confuses practical ability with economic constraints (that is, economic compulsion) inter alia creating inconsistency compared to the IAS 32 debt versus equity classification philosophy.

Consider a vanilla securitisation transaction, where under the terms of the arrangement the receivables are moved to a separate legal entity (the transferee) which also could be collecting cash receipts directly. Where the "practical ability to transfer" test is failed, under the Proposed Approach the transferor would continue to recognise the receivables regardless the fact that the transferor (i) does not control cash flows arising from the securitised receivables; (ii) nor is in a position to enjoy any economic benefits in future.

We do not believe this is a faithful presentation of the securitisation event. This probably stems from the failure of the Proposed Approach to acknowledge that in regard to financial instruments, the ability to direct future cash flow arising from a contractual relationship is probably where control resides.

In our view, the risks-rewards test of the existing derecognition model is better aligned with the current definition of an asset than the "practical ability to transfer" test under the Proposed Approach. See also our response to Question 2.

Question 6 – Accounting for retained interests

Do you agree with the proposed accounting (both recognition and measurement) for an interest retained in a financial asset or a group of financial assets in a transfer that qualifies for derecognition? If not, why? What would you propose instead, and why?

(Note: The accounting for a retained interest in a financial asset or group of financial assets that is proposed in paragraph 21A is not a change from IAS 39. However, the guidance for an interest in a financial asset or group of financial assets retained indirectly through an entity as proposed in paragraph 22A is new.)

Where the proposed derecognition model is applied:

- We agree with requirements in paragraph 21A that a retained part which is a [pro]portion of cash flows, should be measured based on carrying amount at derecognition (on the basis of relative fair values of the part transferred and the part retained). Because in regard to the retained part the economic exposure (or the nature) remains unchanged, it should not be remeasured.
- We do not agree that same measurement apply to an interest in a financial asset or group of financial assets retained indirectly through an entity as proposed in paragraph 22A, especially where the transferee has other financial assets and liabilities. In such an exchange, the transferred item and the acquired interest are fundamentally different in nature which we would have thought should trigger remeasurement.

Question 7 – Approach to derecognition of financial assets

Having gone through the steps/tests of the proposed approach to derecognition of financial assets (Questions 1–6), do you agree that the proposed approach as a whole should be established as the new approach for determining the derecognition of financial assets? If not, why? Do you believe that the alternative approach set out in the alternative views should be established as the new derecognition approach instead, and if so, why? If not, why? What alternative approach would you propose instead, and why?

No, we do not agree that the Proposed Approach as a whole should be established as the new approach for determining the derecognition of financial assets. As we commented elsewhere, we do not see a robust conceptual basis that could be made operational to result in consistently relevant and faithful presentation of financial position of the entity.

We are currently of a view that the existing risks and rewards model better aligns with the nature of financial instruments/contracts. It is operational and to our knowledge, there is no evidence it resulted in grossly inappropriate financial reporting or to any significant extent contributed to the current financial crisis, as opposed to US GAAP securitisation reporting which the FASB just revised as a matter of priority.

This does not mean that the current derecognition model could not be improved. We do see merits in the Alternative Approach which as a pure components approach could be superior because it is the nature of financial contracts. However, it is difficult to comment conclusively given the incompleteness of the discussion of the Alternative Approach. The IASB needs to resolve a conceptual problem of what constitutes an asset and a unit of account as far as financial instruments are involved, to propose a new derecognition model.

Question 8 – Interaction between consolidation and derecognition

In December 2008, the Board issued an exposure draft ED 10* Consolidated Financial Statements*. As noted in paragraphs BC28 and BC29, the Board believes that its proposed approach to derecognition of financial assets in this exposure draft is similar to the approach proposed in ED 10 (albeit derecognition is applied at the level of assets and liabilities, whereas consolidation is assessed at the entity level).

Do you agree that the proposed derecognition and consolidation approaches are compatible? If not, why? Should the Board consider any other aspects of the proposed approaches to derecognition and consolidation before it finalises the exposure drafts? If so, which ones, and why? If the Board were to consider adopting the alternative approach, do you believe that the approach would be compatible with the proposed consolidation approach?

It is not totally clear to us what "compatible" means in this context. The proposed consolidation approach is based on notion of control which as defined in the new proposed standard, is *the power to direct the activities of another entity to generate returns for the reporting entity*. Ultimately, we do not find the current risks-rewards model nor the Proposed Approach incompatible with the proposed consolidation approach.

Question 9 – Derecognition of financial liabilities

Do you agree with the proposed amendments to the principle for derecognition of financial liabilities in paragraph 39A? If not, why? How would you propose to amend that principle instead, and why?

We do not object the proposed amendments to the principle for derecognition of financial liabilities. Our estimate is that it is unlikely to have a significant effect on current practices in general, and especially in jurisdictions where financial institutions have to transfer unclaimed deposits to local governments, of which Australia is one.

Question 10 – Transition

Do you agree with the proposed amendments to the transition guidance in paragraphs 106 and 107? If not, why? How would you propose to amend that guidance instead and why?

We support the proposed prospective application of any amendments arising from this ED.

Question 11 – Disclosures

Do you agree with the proposed amendments to IFRS 7? If not, why? How would you propose to amend those requirements instead, and why?

Overall, we agree with the rationale behind the proposal to enhance some disclosures currently required by IFRS 7. On a detailed point, we note that some of disclosure items, predominantly requested in paragraph 42D, to some extent appear repetitive as similar information is requested somewhere else (e.g. for liquidity disclosures, credit risk disclosures, etc.). Our preference therefore would be to employ standard IFRS language that these are indicative disclosures so that in practice some flexibility is employed to construct disclosures as relevant for the reporting entity, based on its circumstances.