ED184 sub 4

Grant Thornton

Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204,
Collins Street
WEST VICTORIA 8007
By Email: standard@aasb.gov.au

Grant Thornton Australia Limited
ABN 41 127 556 389

Level 17, 383 Kent Street
Sydney NSW 2000
PO Locked Bag Q800
QVB Post Office
Sydney NSW 1230

T +61 2 8297 2400
F +61 2 9299 4445
E info.nsw@grantthornton.com.au
W www.grantthornton.com.au

17 August 2009

Dear Kevin

Grant Thornton Australia Limited (Grant Thornton) is pleased to provide the Australian Accounting Standards Board with its comments on Exposure Draft ED 184 which is a re-badged copy of the International Accounting Standards Board's ED/2009/7 (the ED). We have considered the ED and set out our comments below.

Grant Thornton's response reflects our position as auditors and business advisers both to listed companies and privately held companies and businesses, and this submission has benefited with some initial input from our clients, Grant Thornton International which is working on a global submission to the IASB, and discussions with key constituents.

The views expressed here are preliminary in nature, and a more detailed Grant Thornton's global submission will be finalised by the IASB's due date of 14 September 2009.

Appendix 1 contains our more detailed preliminary responses to both the IASB's and the AASB's questions.

Summary of our views

Our principal comments are as follows:

- we support the Board's efforts to reduce complexity
- we support a mixed measurement model that retains both amortised cost and fair value
- we are concerned with the increased use of fair value for financial liabilities, primarily because this would increase the extent to which gains and losses arise as a result of changes in the issuer's own credit risk
- we believe that the main features of the proposed classification model are broadly appropriate for financial assets but clarification is required to ensure the proposals are operational.

We expand on these comments in the following paragraphs.

Support for reducing complexity

We support the Board's goal to develop a new standard for financial instruments that is more principle-based and less complex than IAS 39. We concur with the view that IAS 39 is difficult to understand and apply for many preparers and that the effects of its application are perhaps even more difficult for users to interpret.

Also, consistent with our comments on the Board's 2008 Discussion Paper *Reducing Complexity in Reporting Financial Instruments* (our September 2008 letter), we believe that reducing the number of measurement categories is a simple and effective way to reduce complexity.

Proposed classification and measurement model

We agree with the main themes of the proposed model, namely to:

- retain a mixed measurement model while reducing the number of measurement categories (as explained in our detailed comments, we do not support a single, fair value measurement model);
- determine the appropriate classification taking account of both the instruments' terms and the reporting entity's business model;
- simplify the accounting requirements for embedded derivatives.

We also support the proposed move to two main measurement categories (amortised cost and fair value). We believe that both measurement bases provide useful information for particular instruments and should therefore have a continued role.

Under a two category model the critical issue for constituents is naturally the basis for deciding which instruments fall into which category (the boundary issue).

Areas of concern on proposed model

Application to liabilities and 'own credit risk'

We are concerned with the likely increase in the use of fair value measurement for liabilities. Under existing IAS 39, fair value is mandatory only for derivatives and other held for trading liabilities. Examples of liabilities that would be measured at fair value in their entirety under the proposals include some convertible bonds, some loans with contingent early repayment features, junior tranches in a securitisation structure and various structured capital instruments.

There are two main reasons for our concern over the increased use of fair value for liabilities:

- we do not generally support reflecting gains or losses from changes in 'own credit risk' in the income statement (we have commented in greater detail on this in our response to the Board's Discussion Paper *Credit Risk in Liability Measurement)*
- we believe in any case fair values are less relevant for liabilities given that:
  - the simplification benefits are fewer, given that financial liabilities are not subject to impairment testing;
  - financial liabilities are rarely transferred or transferable outside of a business combination;
  - if instruments are not transferable, their fair value is likely to be subject to greater estimation uncertainty.

Accordingly, at least until the 'own credit risk' issue is addressed, we would prefer that liabilities (other than derivatives and other held for trading items) continue to be measured at amortised cost. We appreciate that the ED's proposal to eliminate the existing requirement to separate certain embedded derivatives might not be sustainable if this approach is adopted.

Clarity of boundary definitions

The ED proposes that an instrument is measured at amortised cost if, and only if, it:

- has only basic loan features; and
- is managed on a contractual yield basis.

As noted above, we support the ideas underlying these proposed conditions. However, we think they need to be clarified to make them operational. Most importantly, we think that a clear and robust core principle (or definition) is needed for each condition. The detailed supporting guidance should then be aligned with the core principle or definition.

Transition

The ED proposes mainly retrospective application subject to certain impracticality exemptions, some flexibility on when various designations are made and specific requirements on de-designation of previous hedge accounting relationships. We believe these proposals are a good start but we have also identified a number of other transition issues that may need to be addressed. Unfortunately, however, adding more guidance to deal with all the problems could result in a very complex set of rules.

This is turn leads us to ask whether a prospective approach might be a more practical solution.

If you require any further information or comment, please contact me.

Yours sincerely
GRANT THORNTON AUSTRALIA LIMITED

Keith Reilly
National Head of Professional Standards

Appendix 1: Responses to ITC 21 Questions

Invitation to comment questions
Classification approach

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?

Response

Yes, we believe that amortised cost provides useful information in these cases.

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?

Response

We believe that the broad thrust of the guidance on 'basic loan features' and 'managed on a contractual yield basis' is an appropriate basis for setting the boundary between the fair value and amortised cost categories in relation to financial assets. However, we also believe that the draft guidance taken as a whole is somewhat unclear and inconsistent. We recognize that any guidance that could reasonably be developed will be open to some degree of interpretation and judgment. However, we believe that ED's current draft guidance would lead to excessive uncertainty and inconsistent application.

To address these concerns we suggest:

- the core principles (or definitions) need to be clarified;
- the detailed guidance then needs to be aligned with those core principles.

We expand on these comments and offer some suggested improvements in the following paragraphs.

Basic loan features - core principle

The ED does not define 'basic loan features' or otherwise describe the core principle the Board has in mind. Instead the ED includes guidance and some examples in paragraphs B1 to B8. These paragraphs do not in our view sufficiently distinguish the core principle from the detailed examples and application guidance.

We suggest that the core principle should include a notion that a basic loan feature does not give rise to leverage. This is referred to in BC21 and seems important in the context of the more detailed examples.

That aside we suggest that the first two sentences of paragraph B1 are a good starting point. However, we would prefer to avoid using the terms 'interest' or 'principal' in the definition or core principle. This is because we prefer to refer to the economic characteristics of the cash flows rather than use terminology that might be included in an instrument's contractual terms (sometimes in a way that does not reflect those characteristics). For example (i) the 'principal' of a distressed debt instrument may not reflect expected cash flows; (ii) payments linked to company profits might be described as 'interest'.

Drawing together these comments, we suggest a core principle or definition along the lines:

> Basic loan features are contractual terms that give rise on specified dates to cash flows that are not leveraged and which represent return of consideration provided and compensation for the time value of money and credit risk

We suggest that the Board should also consider whether the principle provides clarity on:

- whether, in the case of compound instruments with an equity component, the issuer bases its assessment on the entire instrument or only on the terms of the liability component

- whether the assessment is based only on the contractual cash flows and contractual principal, or whether it incorporates a concept of expected returns and consideration transferred (relevant to distressed debt purchases).

Basic loan features - application to specific instruments and features

Paragraphs B3 to B8 of the Application Guidance set out various examples of features that meet or do not meet the basic loan features condition. We believe that a clearer core principle that describes basic loan features should reduce the need for extensive Application Guidance and examples. We also recognize that the Board wishes to find a balance between including sufficient guidance to clarify the principles and avoiding excessive detail and rules. Nonetheless we believe that even with a clearer principle some additional examples should be included, both to help explain the Board's thinking and to support practical application in common situations.

We also believe that some of the existing guidance should be reviewed and clarified. We comment in more detail below.

Instruments and features included in the draft Application Guidance

- *contractually subordinated tranches* - paragraphs B7 and B8 include guidance to the effect that contractually subordinated tranches do not have basic loan features. At this stage we neither agree nor disagree with this conclusion. We do however suggest that the Board's thinking needs to be explained more clearly. This would assist in distinguishing this scenario from other instruments with junior claims (such as unsecured debt and non-recourse loans). The differentiation seems to be:

  - credit protection that operates by reducing the contractual payments such that non-payment is not a contractual default

  - credit protection (eg by way of limited recourse or subordination) such that non-payment is a contractual default that serves to reduce the creditor's claim only in bankruptcy.
- *contingent prepayment options* - paragraph B3(c) refers to prepayment options and explains that they are basic loan features if they are not contingent on future events. The same paragraph goes on to list a number of 'protective' terms that are not considered to be contingent for this purpose. We think this guidance should be clarified, in particular in relation to the following points:

  - whether the guidance on prepayment options also applies to mandatory prepayment features
  - whether term extension features should be assessed in the same way as prepayment features
  - whether the list of protective terms in intended to be exhaustive or, alternatively, a list of examples. Related to this point we note that terms that accelerate repayment on change of control (or IPO) are commonplace. We believe these are basic loan features and should be addressed in the Application Guidance or illustrative examples.

Instruments and features not included in the draft Application Guidance

- *inflation-linked bonds* - we believe that contractual terms specifying interest linked directly to a standard inflation index (in a non-leveraged and directionally consistent manner) are basic loan features. Such interest terms provide compensation for the time value of money. We also believe that such items are common and should be referred to in the guidance.

- *convertible bonds of the issuer* - in determining whether an instrument has only basic loan features, we understand that instruments are assessed in their entirety, including any embedded derivative feature (consistent with the discussion in BC46). This seems clear with one exception - how to assess convertible bonds with an equity component from the issuer's perspective (or indeed other compound instruments). One view is that the entire instrument should be assessed, even though the equity component is outside the proposed scope of the IFRS. This would lead to an outcome that the instrument 'fails' to have only basic loan features. The other view is that the assessment is based only on the terms of the liability. In that case the liability component may well have only basic loan features and would be measured at amortised cost if managed on a contractual yield basis. Our preference is for the latter view but either way we believe the point should be clarified.

- *perpetual instruments* - the guidance in paragraph B1 refers to payments of principal and interest. This gives rise to a question on whether the absence of repayments of principal (as is the case for perpetual instruments) would cause the instrument to 'fail'. In our view a perpetual bond with 'basic' interest payments should be within the scope of basic loan features.

- *instruments with loss absorption features* - some instruments may include contractual terms (or be subject to statutory requirements) that specify fixed interest or dividend payments but only if there are sufficient available profits. Such terms might be described as loss absorption features. We suggest the guidance is unclear as to whether these features are basic loan features. One view is that such terms would be basic if the payments are cumulative (and vice versa).

Basic loan features - other drafting comments

We have the following more detailed drafting comments:

- Paragraph B1 (third sentence) refers to contractual terms that change the cash flows and states that they are not basic loan features 'unless they protect the debtor or creditor (see paragraph B3(c)'. B3(c) gives a list of terms that protect the lender, along with guidance on debtor prepayment options. We have the following comments on this guidance:

  - the quoted text of B1, as part of the higher level guidance, should ideally clarify the phrase 'protect the debtor or creditor' to indicate the types of protection the Board has in mind;
  - as noted above, the list of protective features in B3(c) could be taken to be exhaustive. We understand however that this is not the intention and that this list is simply a selection of examples. If this is the case we suggest that B1 and B3(c) are clarified accordingly.
- Paragraph 4(a) includes the condition that (to be measured at amortised cost) 'the instrument has only basic loan features'. This suggests that any feature of the instrument that is not a basic loan feature precludes the use of amortised cost. This in turn raises the question of what is meant by a 'feature'. For example, would the inclusion of voting rights in a non-equity financial instrument preclude amortised cost classification? If the intention is to take account only of the nature of any contractual cash-flow features, we suggest the wording should be clarified to this effect.

- We understand that paragraph B3 is intended to set out examples of basic loan features. Accordingly, we suggest that B4 should not refer to '**conditions** for returns in paragraph B3(a)' [emphasis added].

Managed on a contractual yield basis - general principle

We have fewer concerns over 'managed on a contractual yield basis' and believe that the guidance as drafted is probably operational. Nonetheless, we suggest that there are ways in which the guidance could be improved, which should in turn enhance clarity and consistency of application.

Firstly, we suggest that the phrase 'managed on a contractual yield basis' is unhelpful. This is because this phrase:

- is not consistent with how most entities would describe their business model or management process as it applies to financial instruments;
- does not obviously describe what the Board seems to have in mind.

Having said that, the Board's explanations of this condition seem to blend various different notions in a way that makes the overall principle quite difficult to understand or articulate. The guidance in B9-B13 refers mainly to management processes and performance evaluation. BC33 draws a distinction between (i) collection or payment of contractual cash flows; and (ii) realising changes in fair value. Moreover, BC34 refers to the notion of looking at an entity's business model. There is no reference to business model in the draft IFRS itself.

We find the distinction in BC 33 preferable to the existing draft guidance. We also believe that the notion of looking at the entity's business model and its general effects is critical if we are not to be driven back to an intent-based evaluation. With that in mind, we suggest the headline concept might be better described as 'managed on a contractual cash flow basis'. That term might then be defined (or the core principle expressed) along the lines:

> an instrument is **managed on a contractual cash flow basis** if the entity's business model (as it applies to that instrument) is primarily to collect or pay the contractual flows rather than to realise changes in fair values

Managed on a contractual yield basis - specific guidance

We agree with the examples in B12, while suggesting that the formulation suggested would make it more obvious that the instruments meet the condition.

B13(a) clarifies that a held for trading item is not managed on a contractual yield basis. Whilst we naturally agree with this, it is a very obvious example. It might be more helpful to provide an alternative or supplemental example referring, say, to an investment portfolio that is managed to achieve capital growth.

We are not convinced that the example in B13(b), of a financial asset acquired at a discount that reflects incurred credit losses, is either appropriate or correctly positioned with this part of the guidance. On the latter point, we understand that the Board's reason for believing such assets should be measured at fair value has more to do with their leverage (to credit risk) than the acquirer's business model. If so, this guidance should be moved and amended. However we are not in any case convinced that such instruments do or should fail the basic loan features test. This is because:

- if the assessment is based on contractual cash flows, impaired debt assets would seem to meet the basic loan features test. If the assessment is in fact based on expected returns and their link to either (i) contractual principal; or (ii) acquisition price, it is doubtful that the condition is met;

- when an entity acquires a portfolio of debt assets that includes some impaired instruments, we believe that there will be considerable operational difficulties in identifying and fair valuing the specific impaired items.

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?

Response

We believe that these conditions are appropriate for financial assets, subject to our comments in response to Question 2 above.

As noted in the main body of this letter, we have more significant concerns with the likely increase in the use of fair value measurement for financial liabilities.

Embedded derivatives

Question 4

d 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.

e 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?

Responses

a We agree.

b See our comments in response to Question 2.

Fair value option

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?

Response

We agree.

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?

Response

No, we do not envisage any additional circumstances when the fair value option should be available. We agree that the proposed model makes obsolete the other two circumstances included in existing IAS 39 (managed on a fair value basis and embedded derivatives).

Reclassification

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?

Response

We agree that reclassification should be prohibited. Although we believe that it is possible that an entity's business model (as it applies to the instrument in question) might change in a way that would have affected original classification, we expect that these circumstances would be rare. Accordingly, we believe that the inclusion of reclassification requirements (or options) would add unwelcome complexity and would have very limited practical application.

Investments in equity instruments that do not have a quoted market price and whose fair value cannot be reliably measured

Questions 8 and 9

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?

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?

Response

We agree on balance with the ED's proposal to require all equity investments to be measured at fair value in the statement of financial position.

IAS 39 includes an exemption from fair value measurement equity instruments that do not have a quoted market price and whose fair value cannot be reliably measured. We note that the ED does not request views on whether there are circumstances in which a reliable estimate is not possible. BC66 suggests that the Board believes that a valuation is invariably possible and we agree.

We do find the argument in BC65 persuasive. This argues that the added complexity of reported date fair value measurement is offset by the elimination of impairment testing. That would be the case only if impairment testing is required at every reporting date, which is not the case under IAS 39's indicator-driven model. Nonetheless, we view the removal of the impairment requirements as a welcome simplification.

We find it difficult to comment on the costs and benefits question at this level of specificity. We do however believe that reporting equity investments at cost is of little if any informational value. We also believe that maintaining the cost exemption is something of an anomaly both in the context of existing IAS 39 and the proposed new model.

Investments in equity instruments that are measured at fair value through other comprehensive income

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?

Response

We think there are two main issues to consider. The first issue is whether a 'special category' for some equity instruments is appropriate. The second is whether the ED's proposals for the operation of that category are optimal. We address these points under the following sub-headings.

Should the category be included?

We have somewhat mixed views on the desirability of including a 'fair value though other comprehensive income (OCI)' option for equity instruments. This is partly because of the lack of a clear concept or principle governing which types of gain or loss are presented in OCI and which in profit or loss.

This option also adds some complexity to the model. It is in reality a third measurement category. In the absence of robust criteria to determine which instruments belong in this category it seems likely to reduce consistency.

Having said that, we also believe the proposed category has some important merits:

- compared to the existing IAS 39 available for sale category, the proposed approach avoids the considerable complexities associated with split presentation (ie recognising some returns in income and others in OCI), impairment and recycling;

- we agree with the arguments at BC68-69 that the reporting of fair value changes in profit or loss is less appropriate for some equity investments than for others.

These are difficult judgements. However, on balance we support the inclusion of this category.

Should the category be modified?

If this category is to be retained, it is also pertinent to ask if its proposed mechanics are appropriate or optimal. There are perhaps two main issues to be considered:

- is the 'no-recycling' requirement appropriate?
- is it appropriate to record <u>all</u> returns, including dividends, in OCI?

We support the no-recycling proposal. In the absence of any governing principle or conceptual basis for determining which gains and losses are recycled (and when) and which not, our preference is to recognise gains or losses once, in one or other section of the statement of comprehensive income. We also believe that a recycling requirement might lead to less disciplined use of this option.

We believe there is a stronger (although by no means definitive) argument for recognising dividends in profit or loss. This is because:

- we do not perceive any inconsistency between collecting dividend income from an investment while viewing the underlying investment as strategic;
- the dividend gives rise to a new asset, which is distinct from the change in value of the underlying investment.

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?

Response

If the Board decides to include a fair value through OCI category, we believe there is a trade-off between the relative simplicity of an option with a free choice (other than for held for trading investments) and a more principle-based approach.

A more principle-based approach would seek to identify which investments should or could be included in this category based on conditions such as their characteristics, the entity's intentions, or both. This conditions-based approach could be argued to be more robust from a conceptual standpoint and should also contribute to greater consistency. Moreover, there is something of a disconnect between the limited circumstances indicated in the Board's reasons for including this category (BC68-69) and the broad circumstances in which the category would be available. However:

- we agree with the comments in BC70 to the effect that boundary conditions, such as 'held for strategic purposes' will be challenging to develop. Such criteria are likely to require considerable interpretation and judgement to apply, limiting the extent to which consistency is improved in practice;
- conditions would also add to complexity;
- to achieve consistency the fair value through OCI category would also need to be mandatory if the conditions are met which would in turn put further pressure on the expression of the conditions;
- reclassification into and out of this category when conditions are first met or cease to be met would also need to be considered.

On balance, we believe that the Board's proposal for a relatively unfettered (but irrevocable) option is reasonable in all the circumstances. We believe that the option should be irrevocable in order to promote greater discipline in its use.

Effective date and transition

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?

Response

We believe that the additional disclosures proposed should assist users in understanding the effects of transition to the new IFRS. However:

- we note that IAS 8 already specifies various disclosures to be made on a change of accounting policy (including adoption of a new IFRS). These requirements are of course less specific than the proposals in the ED. Nonetheless, we believe that the general IAS 8 requirements should be sufficient;
- if this information is useful we see no compelling reason why only early adopters should be required to provide it. The same information would also be useful in relation to 'on-time' adopters;
- we are concerned that requiring extra disclosure for early-adopters may create a real or perceived disincentive for early adoption. We suggest this is inadvisable.

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?

Response

We agree that retrospective application results in more useful and understandable information. However, we also believe that full retrospective application would in some areas be unduly burdensome and quite possibly impractical.

While we think that the proposed transition provisions are a good start in addressing the likely problems, we do not think they cover all the issues. We also think the requirements on de-designated hedges need to be reworked. We make some more specific suggestions on these points below.

More generally, we are concerned at the complexity of the transitional requirements (as well as the complexity of applying them). Addressing the additional problems, will of course add even more complexity. This in turn causes us to question whether a prospective approach should be considered (at least as far as remeasurement). This might broadly operate on the basis that financial instruments are remeasured at the beginning of the first annual period in which the new IFRS is adopted, with a 'fair value as deemed amortised cost' option. We recognize that such an approach is far from ideal in terms of informational value. However, we also believe that the transition must be practicable.

Exemptions from retrospective application

We consider that the proposed exemptions from retrospective application are appropriate.

We also suggest that the Board should consider the need for some additional relief in relation to instruments derecognised before the new IFRS comes into effect, at least for early adopters.

Date of initial application

We understand that the date of initial application is intended to be a free choice. In other words, entities should designate a date of their choosing in order to apply the transitional provisions that are affected by it. If that is the case, we suggest that the requirement to designate a date is stated explicitly in paragraph 23. Moreover, it is not clear whether this date can be earlier than the publication date of the IFRS.

More substantively, we question whether a free choice of date is appropriate in all cases. We appreciate that the choice of date has limited consequences given that the transitional requirements are largely retrospective. However, the choice of date does have some effect. We also appreciate that some flexibility is required to facilitate adoption by entities with 31 December 2009 year-ends. We suggest however that a free choice of date may not be necessary or appropriate for 'on-time' adopters. We also suggest that some limitations might be appropriate even for early adopters. An alternative approach could be developed along the lines:

- the date of initial application is ordinarily (say) the beginning of the annual period in which the IFRS becomes mandatorily effective or is early adopted;
- for entities that early adopt the new IFRS in a financial period beginning before (say) 1 January 2010, an alternative, later date may be selected (but not later than after the end of the first annual reporting period).

Previous hedging relationships

Paragraph 32 refers to past hedging relationships that are de-designated as a result of the new classification requirements. The guidance proposes that de-designation is effected from the date of initial application. We suggest that discontinuing hedge accounting from the date of initial application is not appropriate if the hedged item is reclassified retrospectively.

Also, the guidance in paragraph 32 cross-refers to IAS 39 paragraphs 91 and 101. Those paragraphs address de-designation in the context of continued application of IAS 39, and require prospective discontinuance. This guidance does not seem clear or (even appropriate) in the context of transition to the new IFRS. Instead we think that the effects of de-designated hedges should cease to be reflected from the earliest date presented when the new classifications take effect (generally the beginning of the earliest comparative period). Also, at that same date:

- for discontinued fair value hedges, any difference between the hedged item's previous carrying amount (including the hedge adjustment) and the new carrying amount should be included;
- for discontinued cash flow hedges (which we would expect to be rarer), any amount in the cash flow hedging reserve should be reclassified into another component of equity.

Other comments

We suggest a link should be made between paragraph 28 (requiring retrospective application of the effects of designating equity investments at fair value through OCI) and paragraph 31 (relief from retrospective fair valuation of investments previously measured at cost).

With reference to paragraph 31 (revocation of prior fair value option elections) we suggest that it would be clearer to state that such designations should be considered to be revoked as at the date of initial application.

An alternative approach

Questions 14 and 15

Do you believe that this alternative approach provides more decision-useful information than measuring those financial assets at amortised cost, specifically?

a in the statement of financial position?

b in the statement of comprehensive income?

If so, why?

Do you believe that either of the possible variants of the alternative approach provides more decision-useful information than the alternative approach and the approach proposed in the exposure draft? If so, which variant and why?

Response

We do not support the alternative approach or either of the possible variants.

Specific AASB Questions

1 Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:

a not-for-profit entities; and
b public sector entities.

Response

Apart from our earlier comments, we are not aware of any regulatory issues that may effect the implementation of the proposals.

2 whether, overall, the proposals would result in financial statements that would be useful to users; and

Response

Apart from our earlier comments, we are not aware of any regulatory issues that may effect the implementation of the proposals.

3 Whether the proposals are in the best interests of the Australian economy.

Response

Apart from our earlier comments, we are not aware of any regulatory issues that may effect the implementation of the proposals.