AASB Exposure Draft

Tier 2 Supplement to ED 230
July 2013

Classification and Measurement: Limited Amendments to AASB 9

(proposed amendments to AASB 9 (2010))

Comments to AASB by 16 September 2013

Australian Government

Australian Accounting Standards Board

Invitation to Comment

Comments on this Tier 2 Supplement to AASB Exposure Draft ED 230 are requested by 16 September 2013.

Comments should be addressed to:

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All submissions on possible, proposed or existing financial reporting requirements, or on the standard-setting process, will be placed on the public record unless the Chairman of the AASB agrees to those submissions being treated as confidential. The latter will only occur if the public interest warrants such treatment.

Obtaining a Copy of this Tier 2 Supplement to AASB ED 230

This Tier 2 Supplement to AASB ED 230 is available on the AASB website: www.aasb.gov.au. Alternatively, printed copies of this Supplement are available by contacting:

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AASB REQUEST FOR COMMENTS

Background

In November 2012, the IASB published ED/2012/4 *Classification and Measurement: Limited Amendments to IFRS 9*, for comment to the IASB by 28 March 2013. ED/2012/4 contains proposals to amend IFRS 9 *Financial Instruments* (2010), proposals to add and amend disclosures in IFRS 7 *Financial Instruments: Disclosures* and proposals to make consequential amendments to other International Financial Reporting Standards.

ED/2012/4 proposes the introduction of a fair value through other comprehensive income (OCI) measurement category for financial debt assets held within a business model in which the assets are managed both in order to collect contractual cash flows and for sale, and that contain contractual cash flows that are solely payments of principal and interest. Currently financial debt assets are required by IFRS 9 to be measured at either fair value through profit or loss or amortised cost.

ED/2012/4 also proposes an amendment to the application guidance in IFRS 9 to clarify that if contractual cash flows on a financial asset include only payments related to principal and consideration for the time value of money and the credit risk, but the economic relationship between those components is modified due to an interest rate mismatch feature or leverage ('a modified economic relationship'), an entity shall assess that modification to determine whether the contractual cash flows represent solely payments of principal and interest. If the modification could result in contractual cash flows that are more than insignificantly different from 'benchmark' cash flows, the contractual cash flows are not solely payments of principal and interest. This would mean that the financial asset would be ineligible to be measured at either amortised cost or, if introduced, fair value through OCI.

Consistent with its policy of adopting International Financial Reporting Standards (IFRSs), in December 2012 the AASB published AASB ED 230 *Classification and Measurement: Limited Amendments to IFRS 9* (for comment to the AASB by 13 February 2013), which incorporates IASB ED/2012/4. The AASB's response to IASB ED/2012/4 is available on the AASB website under Work in Progress/Submissions from AASB.

This Exposure Draft sets out the disclosures in IFRS 7 (and therefore AASB 7 *Financial Instruments: Disclosures*) that AASB ED 230 proposed to amend from which it is proposed entities applying Tier 2 reporting requirements should be exempt. The proposals in this Exposure Draft should not be seen as any indication of AASB support or otherwise for the IASB's proposals in IASB ED/2012/4. That will be determined through the AASB ED 230 due process.

ANALYSIS OF PROPOSED DISCLOSURES

The AASB's conclusions in relation to proposed Tier 2 disclosure requirements in this Exposure Draft have been reached after applying its usual approach to the analysis of the disclosures proposed in AASB ED 230 compared with disclosures set out in the IASB's *IFRS for SMEs* and application of the AASB's 'Tier 2 Disclosure Principles'. Those principles and that analysis are available on the AASB website under Work in Progress/Reduced Disclosure Requirements.

AASB Specific Matters for Comment

The purpose of this Tier 2 Supplement to AASB ED 230 is to seek comment on the disclosure requirements that should apply to Tier 2 entities.

Submissions play an important role in the decisions that the AASB will make in regard to a Standard. The AASB would prefer that respondents supplement their opinions with detailed comments, whether supportive or critical, on the major issues. The AASB regards both critical and supportive comments as essential to a balanced review and will consider all submissions, whether they address all specific matters, additional issues or only one issue.

The AASB would particularly value comments on the following:

1. whether you agree with the AASB disclosure proposals for Tier 2 in the Proposed Reduced Disclosure Requirements section below. Your view is requested only in respect of proposed changes in disclosure requirements arising from ED 230, which are shown as underlined for new text and struck through for deleted text. In addition to any other comments, your view is particularly sought on the proposal to exempt entities applying Tier 2 requirements from making the disclosures reflected in the amendments to paragraph 8(h) . Some Board members are of the view that the proposed disclosure requirements in paragraph 8(h) should be retained for entities applying Tier 2 requirements on the basis that there is a fundamental difference between investments in equity instruments measured at fair value through other comprehensive income (FVOCI) using the irrevocable option and investment in debt instruments mandatorily measured at FVOCI. Those Board members are of the view that the proposed disclosure meets the objective of IFRS 7, as set out in paragraph 1 of that Standard, to require entities to provide disclosures in their financial statements that enable users to evaluate:

   (a) the significance of financial instruments for the entity's financial position and performance; and

   (b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks;

2. 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;

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

4. whether the proposals are in the best interests of the Australian economy; and

5. unless already provided in response to specific matters for comment 1 – 4 above, the costs and benefits of the proposals, whether quantitative (financial or non-financial) or qualitative.

Proposed Reduced Disclosure Requirements

The disclosures proposed in AASB ED 230 are provided below. Entities applying Tier 2 requirements are proposed to be exempted from applying disclosure requirements shown as both shaded text and marked-up text.

PROPOSED REDUCED DISCLOSURE REQUIREMENTS: AASB ED 230

IASB ED/2012/4 *Classification and Measurement: Limited Amendments to IFRS 9*, which was incorporated into AASB's Tier 1 proposals in Exposure Draft ED 230 of the same name, was accompanied by the IASB's Basis for Conclusions. That Basis for Conclusions provides a context to the proposals in that Exposure Draft.

The underlined and struck through text in the following is the same as that in AASB ED 230 (and IASB ED/2012/4). New text is underlined and deleted text is struck through.

Categories of financial assets and financial liabilities

8 The carrying amounts of each of the following categories, as specified in IFRS 9, shall be disclosed either in the statement of financial position or in the notes:

(a) financial assets measured at fair value through profit or loss, showing separately (i) those designated as such upon initial recognition and (ii) those mandatorily measured at fair value through profit or loss in accordance with IFRS 9;

…

(h) financial assets measured at fair value through other comprehensive income, showing separately (i) financial assets that are mandatorily measured at fair value through other comprehensive income in accordance with IFRS 9; and (ii) equity investments designated to be measured as such upon initial recognition.

Financial assets or financial liabilities at fair value through profit or loss

9 If the entity has designated as measured at fair value through profit or loss a financial asset (or group of financial assets) that would otherwise be measured at fair value through other comprehensive income or amortised cost, it shall disclose:

…

Reclassification

12C For each reporting period following reclassification until derecognition, an entity shall disclose for assets reclassified out of the fair value through profit or loss category ~~so that they are measured at amortised cost~~ in accordance with paragraph 4.4.1 of IFRS 9:

(a) the effective interest rate determined on the date of reclassification; and

(b) the interest income or expense recognised.

12D If an entity has reclassified financial assets out of the fair value through profit or loss category ~~so that they are measured at amortised cost~~ since its last annual reporting date, it shall disclose:

(a) the fair value of the financial assets at the end of the reporting period; and

(b) the fair value gain or loss that would have been recognised in profit or loss during the reporting period if the financial assets had not been reclassified.

Allowance account for credit losses

16A The carrying amount of financial assets measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A of IFRS 9 is not directly reduced by an accumulated impairment amount and an entity is prohibited from presenting the accumulated impairment amount in the statement of financial position. However, an entity shall disclose the accumulated impairment amount in the notes to the financial statements.

Items of income, expense, gains or losses

20 An entity shall disclose the following items of income, expense, gains or losses either in the statement of comprehensive income or in the notes:

(a) …

(vii) financial assets designated ~~measured~~ at fair value through other comprehensive income.

(viii) financial assets mandatorily measured at fair value through other comprehensive income, showing separately the amount of gain or loss recognised in other comprehensive income during the period and the amount reclassified upon derecognition from accumulated other comprehensive income to profit or loss for the period.

(b) total interest income and total interest expense (calculated using the effective interest method) for financial assets that are measured at amortised cost or that are mandatorily measured at fair value through other comprehensive income or financial liabilities that are not measured at fair value through profit or loss.

Appendix A – Differences between ED 230 *Financial Instruments: Classification and Measurement: Limited Amendments to AASB 9* and Section 11 *Basic Financial Instruments* of the *IFRS for SMEs*

ED 230 deals with limited amendments to the classification and measurement requirements in IFRS 9 *Financial Instruments*. Section 11 of the *IFRS for SMEs* deals with basic financial instruments and Section 12 of the *IFRS for SMEs* deals with other financial instruments.

The disclosures proposed in ED 230 and the disclosure requirements in Section 11 of *IFRS for SMEs* have been compared in the Analysis to Tier 2 Supplement to AASB ED 230, which is available on the AASB website under Work in Progress/Reduced Disclosure Requirements.

Main Differences in Recognition, Measurement and Presentation Requirements

The proposals in ED 230:

(a) introduce a fair value through other comprehensive income (FVOCI) measurement category for financial debt assets held within a business model in which the assets are managed both in order to collect contractual cash flows and for sale, and that contain contractual cash flows that are solely payments of principal and interest. Currently financial debt assets are required by IFRS 9 to be measured at either fair value through profit or loss or amortised cost; and

(b) would amend the application guidance in IFRS 9 to clarify that if contractual cash flows of a financial asset include only payments related to principal and consideration for the time value of money and the credit risk, but the economic relationship between those components is modified due to an interest rate mismatch feature or leverage ('a modified economic relationship'), an entity shall assess that modification to determine whether the contractual cash flows represent solely payments of principal and interest. If the modification could result in contractual cash flows that are more than insignificantly different from 'benchmark' cash flows, the contractual cash flows are not solely payments of principal and interest. This would mean that the financial asset would be ineligible to be measured at either amortised cost or, if introduced, fair value through OCI.

These proposals differ from the financial assets requirements in Sections 11 and 12 of the *IFRS for SMEs* as follows:

- *IFRS for SMEs* does not have a FVOCI measurement category for financial instruments; and
- *IFRS for SMEs* does not require that the contractual cash flows of a financial asset include only payments related to principal and consideration for the time value of money and the credit risk, in order that the financial asset is eligible for measurement at amortised cost. Instead *IFRS for SMEs* requires that debt instruments that satisfy all the conditions specified below, are measured at initial recognition at the transaction price (including transaction costs except in the initial measurement of financial assets and liabilities that are measured at fair value through profit or loss) unless the arrangement constitutes, in effect, a financing transaction, in which case the entity measures the financial asset at the present value of the future payments. Subsequently these debt instruments are measured at amortised cost using the effective interest method. The specified conditions of the debt instrument are as follows:

    (a) the returns to the holder of the instrument are:

        (i) a fixed amount;
        (ii) a fixed rate of return over the life of the instrument;

(iii) a variable return that, throughout the life of the instrument, is equal to a single referenced quoted or observable interest rate (such as LIBOR); or

(iv) some combination of such fixed rate and variable rates, provided that both the fixed and variable rates are positive;

(b) there is no contractual provision that could, by its terms, result in the holder losing the principal amount or any interest attributable to the current period or prior periods. The fact that a debt instrument is subordinated to other debt instruments is not an example of such a contractual provision;

(c) contractual provisions that permit the issuer (the debtor) to prepay a debt instrument or permit the holder (the creditor) to put it back to the issuer before maturity are not contingent on future events; and

(d) there are no conditional returns or repayment provisions except for the variable rate return described in (a) and prepayment provisions described in (c).