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Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West VIC 8007

7 August 2009

Dear Kevin

Exposure Drafts ED 177, ED 178 and ED 182

I am enclosing copies of the PricewaterhouseCoopers responses to the following International Accounting Standards Board's Exposure Drafts:

- *Derecognition – Proposed Amendments to IAS 39 and IFRS 7* [AASB ED 177]
- *Income Tax* [AASB ED 178], and
- *Prepayments of a Minimum Funding Requirement (IFRIC 14)* [AASB ED 182].

The letters reflect the views of the PricewaterhouseCoopers network of firms and as such include our own comments on the matters raised in the Exposure Drafts.

We would welcome the opportunity to discuss our views at your convenience. Please contact me on (03) 8603 3868 if you would like to discuss this further.

Yours sincerely

Jan McCahey
Partner
Assurance

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Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
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31 July 2009

Dear Sir

Exposure Draft Derecognition – Proposed amendments to IAS 39 and IFRS 7

We are responding to your invitation to comment on the above draft amendments to IAS 39 and IFRS 7 on behalf of PricewaterhouseCoopers.

Following consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of member firms who commented on this exposure draft. "PricewaterhouseCoopers" refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We welcome the opportunity to comment on the Board's proposals on this important topic. We recognise the significant efforts that the Board is making to respond to current economic events and the requests of the Financial Stability Forum.

In view of the commonality of financing structures around the world, we believe it is essential that they are accounted for in the same way under different accounting regimes. Consequently we support the IASB and the FASB working together to develop a converged standard. We acknowledge the need for a solution to be finalised quickly but would nonetheless encourage the Boards to take account of comments from both consultation processes before finalising a standard at the same time.

Basic principle

An asset is defined in the Framework as a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity. Given the importance of the concept of control in this definition, we support the Board's proposal to establish control as the principle underlying the derecognition assessment. Furthermore, as we indicated in our response to your invitation to comment on the Exposure Draft ED 10 Consolidated Financial Statements, we believe that any changes to accounting for derecognition must be consistent with the revised consolidation requirements. It is also important to ensure that the resulting derecognition model is consistent with the anticipated amendments to the classification and measurement requirements for financial instruments in IAS 39.

Proposed model

We do not support the derecognition model set out in the exposure draft since it does not result in accounting that reflects the transferor's exposure to the rights and obligations of the financial asset

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We acknowledge that some have criticised accounting standards for permitting the removal of too many financial assets from the balance sheet. However, we do not support the retention of financial assets on the balance sheet which no longer meet the definition of an asset. It is important to strike the right balance by recognising the extent of the reporting entity's remaining control of and rights to the cash flows of the asset rather than allowing subsequent accounting to be unduly influenced by the extent of previous involvement in the asset.

For example, under the proposed model it is likely that few, if any, factoring arrangements will be derecognised, since the transferor typically retains servicing rights that would be considered to be a form of continuing involvement in the absence of removal rights. Equally, securitisation transactions in which the entity retains an insignificant and disproportionate interest in the transferred assets (such as a senior interest) will also fail derecognition, resulting in the recognition of an associated liability in respect of which the transferor has no obligation to transfer resources, other than to pass on cash received from the assets in an agency capacity. Repurchase agreements, however, will achieve derecognition, despite these being viewed almost universally as financing arrangements, with the transferred asset being collateral held against a borrowing.

The proposed model contains a definition of control based on an assessment of whether the transferee has the practical ability to dispose of the asset in its entirety. We believe that the test for control should consider whether the transferor has retained control over the asset, rather than whether the transferee has obtained control. Delaying derecognition until the transferee has gained control results in the recognition of assets that the transferor no longer controls, and therefore results in the continued recognition of assets that do not meet the Framework definition. Defining control in this way (ie by assessing control from the perspective of the transferee rather than from that of the transferor as the reporting entity) would not be consistent with the proposals in ED10 which considers control from the perspective of the reporting entity. Put another way, recognition of financial assets and the consolidation of subsidiaries are determined based on evaluating the rights of the reporting entity over the financial asset or subject entity. Derecognition and deconsolidation should be determined in the same way (that is, from the perspective of the reporting entity).

Alternative View

At a conceptual level, we support the approach outlined in the Alternative View in the exposure draft. This model has the following advantages over the proposed model:

- It results in the recognition of assets where the reporting entity has control over the future economic benefits inherent in the asset, and does not result in the recognition of liabilities for which the entity has no obligation to give up its resources;
- It considers control over the cash flows of the asset from the transferor's perspective, and avoids an overlay of risks and rewards;
- It is not built on the premise that assets are 'sticky'; two entities with the same contractual rights and obligations will account for them consistently, irrespective of whether one of the entities previously owned the transferred asset; and
- It significantly reduces complexity in determining when financial assets should be derecognised compared to both the current model and the proposed model.

The model outlined in the Alternative View is likely to result in more transfers of financial assets achieving derecognition of the original asset, although it does require recognition of the retained rights and obligations in those transferred assets. Some may view this outcome as inconsistent with the perceived need for less derecognition. On balance, we believe users will be best served by representing on the balance sheet only those financial instruments which the entity controls or for which it has the obligation to give up its resources. However, we are concerned that this model results in gain or loss recognition in the income statement on a financial asset in its entirety even though there has been no change in its rights to some of the underlying cash flows of that asset.

While selective gain recognition is possible today through wash sales of assets traded in an active market, the Alternative View would extend the recognition of such gains to illiquid assets.

The Alternative View also results in derecognition of financial assets transferred in repurchase agreements and securities lending arrangements. These transactions are well understood by both preparers and users to be financings and should, in our view, be accounted for as such.

To address these perceived shortcomings of the Alternative View, we set out below some possible amendments to that model.

Gain recognition for retained interests

As indicated above, the model outlined in the Alternative View allows gain or loss recognition on the whole asset even if the transferor's retained interest in the underlying cash flows is substantially unchanged. One way to address this would be to require the transferor to assess the extent to which its exposure to those cash flows has changed in such a way as to change the measurement basis of the retained asset. Therefore we propose that, where the cash flows underlying its retained interest in the financial asset are substantially generated by the transferred asset, and the retained interest qualifies for amortised cost measurement, no gain or loss should be recognised relating to the retained interest. The carrying amount of the transferred asset would be allocated between the retained interest and the other assets or liabilities received based on relative fair values. However, where the retained interest is one that would be carried subsequently at fair value or is not substantially generated by the transferred asset, this revision would recognise that the transaction has resulted in a substantial change in the entity's exposure to the rights and obligations associated with the underlying cash flows and a gain or loss would be recognised on initial recognition of the retained interest. Since this issue arises from the existence of a mixed attribute measurement model for financial assets, its significance will depend on the final outcome of the Board's deliberations on the classification and measurement of financial instruments.

Repurchase agreements and securities lending arrangements

Repurchase agreements and securities lending arrangements are unique transactions where the transferor of the financial asset will receive the same (or substantially the same) asset that it transferred, usually within a short time frame. Although one could argue that the economics of these arrangements are similar to a sale of the financial asset with a forward repurchase commitment, these transactions differ from a typical forward purchase agreement in that the transferor is (i) paid the interest and dividends from the transferred asset and (ii) assured that the transferred asset will be returned via the provision of collateral that is valued daily and adjusted frequently for changes in the market value of the transferred asset. The transferor is entitled to the collateral should the transferee default. However, the transferee is exposed to the transferor's credit risk on the return of cash (ie the repurchase price), similar to a secured lender in a financing. These provisions are not typical of forward contracts where collateral arrangements generally protect only the fair value of the forward for both counterparties. The argument presented above is described in the basis of conclusions in guidance on transfers of financial assets in US standards, which view these transactions as borrowings rather than sales with retained forward purchase contracts.

We understand that accounting for these transactions as financings reflects users' and preparers' shared view of them and, as a result, we believe that this would facilitate a user's understanding of the impact of these particular transactions on the financial statements. We therefore propose that the definition of a transfer be amended to explicitly exclude assets subject to these types of repurchase arrangements.

Disclosures

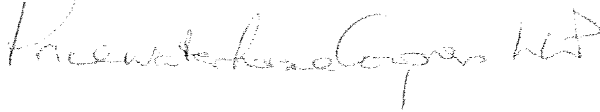
We support the need for additional disclosures around the transferor's exposure to risk as a result of transfers of financial assets but do not believe that this is best achieved by a comprehensive list

of disclosure requirements. Paragraphs 42D and 42E require a voluminous amount of information to be disclosed that may obscure relevant information with an excess of detail.

We recommend the establishment of a principle for disclosures focusing on the risk retained by the transferor. The principle should be applied to all financial assets that are the subject of transfers and in which the entity has retained an interest. Under such a principle, an entity would be required to disclose information to the extent that it is necessary for an understanding of the effect that such transactions have, or may have, on its financial position, profit or loss, liquidity and capital resources.

Our responses to the specific questions in the exposure draft are attached in Attachment A to this letter. If you have any questions on the content of this letter, please do not hesitate to contact Richard Keys, PwC Global Chief Accountant (+44 20 7212 4555), or Pauline Wallace (+44 20 7804 1293).

Yours faithfully



PricewaterhouseCoopers LLP

ED Derecognition – Proposed amendments to IAS 39 and IFRS 7
Attachment A
Response to Detailed Questions

Introduction

As discussed in our covering letter, we do not support the model proposed in the exposure draft and we have proposed an amended version of the model outlined in the Alternative View. However, in the interests of helping the Board if it were to continue with the proposed model, we have nevertheless responded to the questions that were presented in the exposure draft in that context. Our detailed comments should not, however, be taken as support for the proposed model.

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 (see paragraphs 15A, AG37A and AG47A)? If not, why? What would you propose instead, and why?

We agree that the determination of the Asset to be evaluated for derecognition, and the assessment of continuing involvement, should be made at the level of the reporting entity.

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.)

As noted in our covering letter, we do not support the derecognition model set out in the exposure draft (the "proposed model"). Instead, we agree with the concept underlying the Alternative View in the exposure draft that the unit of account is the entire asset; control should be assessed at this level.

If, however, the Board continues with the approach proposed in the exposure draft, in the context of that model we would support the application of derecognition principles to a part of a financial asset in those circumstances in which it is allowed at present by IAS 39.16, namely where the part comprises:

- (a) specifically identified cash flows of the asset;
- (b) a fully proportionate share of the cash flows of the asset; or
- (c) a fully proportionate share of specifically identified cash flows of the asset.

We note that item (c) has been removed in paragraph 16A of the exposure draft. This would appear to represent a change to the current requirements that would, for example, prevent an entity from assessing for derecognition 50% of the interest coupon on a debt instrument in which it retained the remaining cash flows of the asset. We do not support this change.

We note that paragraphs 16A and AG42A do not contain the existing requirement for assets to be similar in order to be considered together as a group of assets in the derecognition test. We support this amendment, as this concept has caused difficulties in practice. However, the application of AG42A in the absence of a 'similar asset' requirement mandates that all

transfers of groups of assets must be assessed as a single group (to the extent that none of the assets in the group is an instrument that may be an asset or liability over its life). We are concerned that this may result in assets transferred together, but which possess different risks, 'tainting' the entire portfolio. For example, an entity may transfer a portfolio of receivables that incorporates both functional currency and foreign currency assets. It is common in some jurisdictions for the entity to remain exposed to movements in the spot exchange rate following the date of transfer of the foreign currency receivables (typically a small part of the overall portfolio), but to have no continuing involvement in the functional currency receivables. The proposed model would prevent derecognition of any receivables in such a situation due to the tainting effect of part of the group. We therefore recommend that an entity be allowed to elect to sub-divide the group into smaller groups that possess different characteristics, and perform separate derecognition tests for each sub-group.

It is unclear whether the term 'groups of financial assets' in AG42A is intended to exclude insurance contracts associated with the transfer of pre-insured receivables, as insurance contracts meet the definition of financial assets yet are scoped out from the requirements of IAS 39. The transfer of pre-insured receivables is a common scenario in factoring arrangements; the amendment should be clear regarding the application of any proposed derecognition test to such instruments.

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 agree with the inclusion of a broad definition of what constitutes a transfer for the purposes of the derecognition test. However, we note that both the proposed and alternative models in the exposure draft result in derecognition of financial assets that are transferred yet subject to a repurchase agreement or stock lending arrangement. As discussed in more detail in our covering letter, these are unique transactions with provisions that may appear to be similar to the sale of a financial asset with a forward repurchase commitment but which contain provisions that are not typical of forward contracts. We understand that accounting for these transactions as financings reflects users' and preparers' shared view of them and believe that this should be recognised in the Board's proposals. We therefore recommend that the definition of a transfer should be amended to exclude the delivery of a financial asset (or substantially the same asset) that the entity is required to repurchase in the future so that these transactions can continue to be accounted for as secured financings.

The transfer definition incorporates reference to the passage of 'economic benefits underlying one or more of its assets'. It is unclear to which rights the term economic benefits is intended to apply, other than rights to cash flows underlying the Asset. BC8-BC10 provides guidance regarding the term future economic benefits, in particular the reference to benefits arising from direct or indirect access to cash flows (or the instrument transferred), that we believe should be elevated to the standard. We also recommend that the definition be amended to clarify that it relates only to the transfer of *financial* assets, including *financial* collateral.

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?

Even if the Board continues with the approach proposed in the exposure draft, we do not support the inclusion of a 'continuing involvement' filter.

This filter represents a risks and rewards overlay that is inconsistent with the move to a control model. This overlay is required in the proposed model principally due to a flawed definition of control; an outright sale of an instrument that is not quoted in an active market would otherwise not achieve derecognition unless it was possible to demonstrate that the transferee has the practical ability to dispose of the asset. A more natural interpretation of the term "control" would focus on the extent to which the transferor continues to have the ability to control the asset, which would make the additional risks and rewards filter unnecessary.

Furthermore, the term continuing involvement captures items that are insignificant to the risks and rewards of the transferred asset, such as the retention of servicing rights in a fiduciary or agency relationship (irrespective of whether there are removal rights). We do not believe that such incidental features of a transfer should be determining factors in the derecognition test.

While certain items have been scoped out in paragraphs 18A and AG49A, we do not support the inclusion of such a list of exceptions to continuing involvement. A list of exceptions without an underlying principle may not be capable of application to transactions that are economically similar but have a different form, and therefore any list is likely to be incomplete. For example, we believe that a transferor's ability to issue discretionary credit notes against factored receivables (often referred to as 'dilution risk') should not constitute a continuing involvement that would prevent derecognition. To the extent that the Board retains a continuing involvement filter in the way currently defined, we believe that a principle should be established that defines those forms of continuing involvement in the cash flows of the asset that should be taken into account. We also recommend that any guidance regarding fiduciary or agency arrangements should be consistent with that incorporated in any new consolidation standard.

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?

If the Board continues with the approach proposed in the exposure draft, we do not agree with the proposed 'practical ability to transfer for the transferee's own benefit' test in paragraph 17(c). As we noted in our covering letter, we believe that any revisions to the derecognition framework must be consistent with the definition of an asset in the Framework and with the proposed consolidation requirements. Consequently, the test for control should be based on the retention of control over the asset by the transferor, rather than whether the transferee's ability to exercise control. Defining control in this way would be consistent with both the definition of an asset and the proposals in ED10.

Assessing the retention of control by the transferor or the receipt of control by the transferee should provide consistent conclusions. However, gaps appear due to the definition of control used in the derecognition exposure draft. The requirement that the transferee should have a

practical ability to dispose[1] of the asset relies disproportionately on a single indicator of whether the transferee controls the asset.

For example, consider the transfer of an unquoted financial asset to a third party. As part of the transfer, the transferor has written a put option over the asset that is presently out of the money. Since the transferee does not have the practical ability to dispose of the asset, as defined in AG52L(b) of the exposure draft, the transferor would be considered as retaining control of the asset. While the transferor has retained certain risks associated with the asset, the transferor does not have present access to the cash flows of the asset in the above scenario, nor does it have any rights or obligations associated with those cash flows. The transferor has adopted a stand-ready obligation to buy back the asset if required to do so, but does not have the ability to require the transferee to return the asset so as to deprive the transferee of the benefit of those cash flows. Accordingly, we do not believe that the transferor controls the asset.

We support the control concept that underlies the Alternative View, which assesses whether the transferor has control over all of the future economic benefits inherent in the asset, and an ability to restrict others' access to those benefits. The unit of account in the Alternative View is the entire asset; if the transferor loses control over any of the future economic benefits inherent in the asset, its interest (if any) in the transferred asset represents a different asset. Our views regarding the measurement of assets received and liabilities incurred as part of the transfer are set out in our response to Question 7.

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 (for a retained interest in a financial asset or group of financial assets, see paragraph 21A; for an interest in a financial asset or group of financial assets retained indirectly through an entity, see paragraph 22A)? 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.)

As noted in our covering letter, we do not agree with the proposed model included in the ED. If, however, the Board continues with this approach, we would agree with the proposed accounting for a direct interest retained in a financial asset or a group of financial assets (paragraph 21A).

We agree with the accounting proposed for the retained interest by paragraph 22A where the interest retained is held indirectly through a special purpose entity with no other assets, liabilities or operations, such that there is no substantive change in the entity's holding before and after the transaction. However, in these circumstances, it is likely that the special purpose entity would be consolidated by the transferor and therefore there is no derecognition from the perspective of the group. Where the holding in the transferee entity is more indirect, we support the comments in AV14 that the approach is unlikely to be operational since the transferor may not be aware of all the assets and liabilities held by the transferee

[1] Paragraph 17A(c) refers to the 'practical ability to **transfer**' the asset. However, it is clear from the application guidance contained in AG52B that the requirement is that the transferee has the practical ability to **dispose** of the asset.

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?

As discussed in our covering letter we do not agree that the proposed approach should be established as the new approach for determining the derecognition of financial assets. This is primarily because it fails to reflect the transferor's exposure to the rights and obligations of the financial asset.

For example, under the proposed model it is likely that few, if any, factoring arrangements will be derecognised, since the transferor typically will retain servicing rights that would be considered to be a form of continuing involvement, as removal rights are not substantive. Equally, securitisation transactions in which the entity retains an insignificant, disproportionate interest in the transferred assets (such as a senior interest) will also fail derecognition, resulting in the recognition of an associated liability in respect of which the transferor has no obligation to transfer resources, other than to pass on cash received from the assets. Repurchase agreements (or 'repo' transactions), however, will achieve derecognition, despite these being viewed almost universally as financing arrangements, with the transferred asset being collateral against a borrowing.

Furthermore, as discussed in our response to question 5 above, we do not support the definition of control used in the proposed model.

The Alternative View considers whether the transferor has access at present, for its own benefit, to all of the cash flows or other economic benefits of the financial asset. At a conceptual level we support the approach outlined in the Alternative View. This model has the following advantages over the proposed model:

- It results in the recognition of assets in respect of which future economic benefits will flow to the entity, and does not result in the recognition of liabilities for which the entity has no obligation to give up its resources;
- It considers control over the cash flows of the asset from the transferor's perspective, and avoids an overlay of risks and rewards;
- It is not built on the premise that assets are 'sticky'; two entities with the same contractual rights and obligations will account for them consistently, irrespective of whether one of the entities previously owned the transferred asset; and
- It significantly reduces complexity in determining when financial assets should be derecognised compared to both the current model and the proposed model.

As discussed in our covering letter, we are concerned that the model results in gain or loss recognition in the income statement on a financial asset in its entirety even though there has been no change in the transferor's rights to some of the underlying cash flows of that asset and the asset representing those retained cash flows continues to be carried at amortised cost. As discussed in our response to question 3 above, we are also concerned that the alternative model results in derecognition for repurchase agreements and stock lending arrangements, which does not reflect the way in which both users and preparers view these transactions. We suggest in our covering letter amendments to the model outlined in the Alternative View that would address these concerns.

In the context of the Alternative View as set out in the ED, we find the notion of 'present access' to cash flows confusing. It is unclear, for example, whether a transferor with an option to reacquire an asset has present access to the cash flows, or whether it needs to exercise the option before having access, at present, to those cash flows. It is also unclear whether the transferee's ability to sell the transferred asset impacts whether the entity has present access to the cash flows of that asset for its own benefit where there is a repurchase right and obligation. We note that there are similarities between the term "present access" and the concept of "potential voting rights" in ED10. If the Board decides to pursue this model, we would recommend that these issues are addressed in the final standard.

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 that approach would be compatible with the proposed consolidation approach?

We do not believe that the proposed derecognition model is compatible with the approach to consolidation set out in ED10. Consolidation focuses on the reporting entity's ability to exercise control assets and liabilities to obtain benefits; the approach to control proposed in the exposure draft assesses what others can do with the transferred asset. This difference in approach can result in divergent conclusions regarding whether the transferor controls an asset. An example of such a scenario is set out in our response to Question 5.

The requirement that the transferee should have a practical ability to dispose of the asset relies disproportionately on a single indicator of whether the transferee controls the asset.

We believe that the alternative approach is compatible with the proposed consolidation approach. The alternative approach assesses whether the transferor has control over all of the future economic benefits inherent in the asset.

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 agree with the proposed principle for the derecognition of financial liabilities in the exposure draft. We recommend that this is modified to require derecognition when the liability ceases to qualify as a **financial** liability of the entity. The second sentence of paragraph 39A appears to be driven by the definition of a liability in the Framework and IAS 37, rather than the definition of a financial liability in IAS 32. The proposed wording constrains the circumstances in which a recognised financial liability ceases to qualify as a liability to those

where the present obligation is eliminated and the entity is no longer required to transfer economic resources in respect of that obligation. This constraint will result in an entity continuing to recognise a liability for a continuing obligation that does not meet the definition of a financial liability.

For example, an obligation to deliver the entity's own equity instruments may cease to meet the definition of a financial liability in IAS 32 where the number of equity instruments becomes fixed subsequent to initial recognition. We believe that such obligations should also be derecognised when they no longer meet the definition of a financial liability.

The existing '10% test' regarding both exchanges of, and modifications to, debt instruments with the creditor has been retained in paragraph 40A and AG62. We recommend that paragraph 42B should be expanded to clarify that the effective interest rate should be reset for debt instruments for which the modification was not substantial. In the absence of such a statement it may be argued that AG8 should be applied to the financial liability, giving rise to a gain or loss on re-measurement; this treatment would be inconsistent with the requirement in paragraph 42B that costs or fees incurred should be amortised over the remaining term of the liability.

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 agree with the proposed amendments to the transition guidance in paragraphs 106 and 107.

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?

The proposed disclosure requirements are voluminous. Paragraph 42C requires an entity to disclose information that enables users to evaluate the nature of risks associated with the entity's continuing involvement in those derecognised financial assets. However, paragraphs 42D and 42E mandate an extensive 'shopping list' of information that is likely to obscure relevant information behind an excess of detail. Indeed, the disclosures for derecognised financial assets are significantly greater than for those financial assets that the entity still controls.

We suggest that a principle should be established for disclosures. The principle could be used by preparers of financial statements to provide appropriate and risk focused disclosures. The principle should be applied to all financial assets which are subject to a transfer and in which the entity has retained an interest. Under such a principle, an entity would be required to disclose information to the extent that it is necessary for an understanding of the effect that such transactions have, or may have, on its financial position, profit or loss, liquidity and capital resources.
The transitional provisions proposed in paragraph 106 require prospective application of the derecognition requirements to transactions after the effective date of the amendment. This transitional arrangement eliminates the need to assess previous transfers for derecognition under the proposed amendment. The transitional provisions in IFRS 7.44H, however, require the entity to make disclosures based on an assessment of historical transfers under the

proposed amendment. In view of the conclusion reached in respect of assessing transfers for derecognition prospectively, which we support, we consider the disclosure requirement to be excessively onerous. We therefore believe that, consistent with the proposed amendment to IAS 39, the proposed disclosures should be applied prospectively to transfers after the effective date, or an earlier date provided that the entity obtained the information needed to apply the amendments at the time it initially accounted for those transactions.

Other Comments

Issues have arisen in practice regarding the accounting for the modification of a financial asset that results from a renegotiation between the borrower and lender. Under existing guidance there is no transfer of a financial asset. The derecognition, or otherwise, of the financial asset (and related recognition of a new asset for the renegotiated debt) is therefore dependent on an assessment of whether the rights to the cash flows of the asset are deemed to have expired as a result of the renegotiation.

Consistent with the existing derecognition model in IAS 39, paragraph 40A of the exposure draft requires an assessment of whether a modification in terms of a financial liability is substantial. We recommend that the Board should consider whether similar guidance is required for modifications to financial assets.