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

via email: standard@aasb.gov.au

8 April 2013

Dear Kevin

Re: Submissions on AASB ED 228, ED 230, ED 231, ED 235 and ED 236

I am enclosing a copy of PricewaterhouseCooopers' responses to the following International Accounting Standards Board's Exposure Drafts:

- ED 228 (IASB ED/2012/3) *Equity Method: Share of Other Net Asset Changes (proposed amendments to AASB 128)*
- ED 230 (IASB ED/2012/4) *Classification and Measurement: Limited Amendments to AASB 9 (proposed amendments to AASB 9 (2010))*
- ED 231 (IASB ED/2012/5) *Clarification of Acceptable Methods of Depreciation and Amortisation (proposed amendments to AASB 116 and AASB 138)*
- ED 235 (IASB ED/2013/1) *Recoverable Amount Disclosures for Non-Financial Assets (proposed amendments to AASB 136)*
- ED 236 (IASB ED/2013/2) *Novation of Derivatives and Continuation of Hedge Accounting (proposed amendments to AASB 139 and AASB 9)*

The letters reflect the views of the PricewaterhouseCoopers (PwC) network of firms and as such include our own comments on the matters raised in the requests for comment. PwC refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

I would welcome the opportunity to discuss our firm's views at your convenience. Please contact me on (02) 8266 7104 if you would like to discuss our comments further.

Yours sincerely,

Paul Shepherd
Partner, PricewaterhouseCoopers

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International Accounting Standards Board
30 Cannon Street
London
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United Kingdom

28 March 2013

Dear Sir/Madam,

Exposure Draft – Classification and measurement: Limited amendments to IFRS 9

We are pleased to respond to the invitation by the IASB (the 'Board') to comment on behalf of PricewaterhouseCoopers on the Exposure Draft ('ED'), Classification and measurement: Limited amendments to IFRS 9. Following consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of those member firms who commented on the 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 agree with the Board's objectives to amend IFRS 9 and commend the Board on their progress in achieving those objectives. Our responses to the Board's questions are included in the Appendix to this letter. The key comments that we would like to raise with the Board are summarised below.

Business model assessment: the 'fair value through other comprehensive income' (FVOCI) measurement category for eligible debt investments

We support the Board's proposal to introduce a third measurement category, FVOCI, in addition to the amortised cost (AC) and fair value through profit or loss (FVPL) categories that currently exist in IFRS 9. Financial instruments are complex and we believe that the difficulties identified by constituents in preparing to implement IFRS 9 demonstrate that two measurement categories are too limited to allow entities to properly reflect the broad range of activities undertaken and the reasons that entities have for holding these instruments. In considering the introduction of the third category, we believe that the measurement of financial assets provides relevant information to users of financial statements that is based on how the entity will realise the contractual cash flows on those financial assets (either through collecting the cash flows, through sale or a combination of both).

In addition, the FVOCI category is particularly important since the Board, as part of these amendments, is clarifying the business model for financial assets that are held to collect the contractual cash flows which may result in a narrower AC category than how some constituents had originally interpreted the IFRS 9 requirements. Without the FVOCI category, portfolios of debt investments that an entity may invest in to generate yield but also to sell if the price is considered advantageous or where the portfolios are periodically rebalanced would be mandatorily classified as FVPL. We do not believe this provides the best information for investors as it is inconsistent with the underlying business strategy.

Contractual cash flow characteristics assessment: modified economic relationship between principal and interest

We support the Board's objective to clarify that those financial assets with a modified economic relationship between principal and interest may still represent cash flows that are solely payments of principal and interest (SPPI). Whilst the new 'modified economic relationship test' provides a structured approach for assessing whether an instrument meets SPPI, we believe that a threshold based on a 'significant difference' rather than on a 'more than insignificant difference' more clearly communicates the Board's objective and will be easier to translate into different languages. We believe that a 'significant difference' in cash flows is an appropriate level to identify instruments that should represent SPPI cash flows under the model.

We also acknowledge that some are concerned that the modified economic relationship test may be problematic for instruments in certain jurisdictions where the mechanism of resetting the interest rate is the same for all instruments, regardless of the remaining maturity of the instrument. If such a mechanism represents the only permitted pricing basis available for this type of instrument in a particular jurisdiction and the underlying economics of the instrument is structured to otherwise compensate for the time value of money and the credit risk of the borrower, we believe it should not preclude the instrument from meeting the SPPI criteria. We recommend that the Board clarify that if such instruments are in the scope of the modified economic relationship test, the 'benchmark' for such extensively regulated instruments should reflect the fact there is only one permitted pricing basis for those instruments, rather than a theoretical instrument that could not exist in practice in the particular economic environment. However, if in the relevant jurisdiction, similar instruments are (or subsequently become) available on other pricing bases (for example, a periodic reset to a rate that reflects the remaining time to maturity of the loan), the modification test would be relevant and the benchmark instrument should include the pricing basis that reflects the remaining time to maturity.

Additional proposed changes

Fair value option
We continue to support an unrestricted fair value option rather than having an option only to reduce an accounting mismatch. The ability to carry any financial asset at fair value through profit or loss is important to many entities, particularly in the financial services sector. We believe that an unrestricted option will be useful for many entities that may not want to apply complex hedge accounting rules or for entities that prefer to carry their investments at FVPL in those circumstances where it might yield more decision-useful information to investors but when such investments might otherwise mandatorily meet the criteria to be classified as FVOCI or AC. An unrestricted option is also consistent with the fact that FVPL is considered the residual category in IFRS 9.

Whilst we understand that historically some have opposed an unrestricted fair value option, we believe it will enable preparers to select a fair value measurement basis in circumstances where it provides more decision-useful information to investors. The election for the fair value option should be transparent and properly disclosed in the financial statements.

Equity investments
We support the existing irrevocable election for gains and losses on equity investments to be presented in FVOCI. However, we believe that precluding recycling of gains and losses is inappropriate. As we have previously expressed to the Board, we support recycling as it is consistent with the concept of profit or loss being the key performance measure for investors. Further, given the Board's decision on

recycling for debt investments qualifying for the FVOCI category, we believe the existing FVOCI model for equity investments is inconsistent and thus will be confusing for investors.

In addition to the irrevocable FVOCI election, we believe the Board should also consider introducing a practical exception for equity investments without readily determinable fair values to be measured at cost less impairment adjusted for observable market transactions, with changes being recognised in profit or loss. Whilst we believe that in many cases the fair value of such instruments can be estimated using models, we acknowledge that entities continue to encounter challenges in determining fair value due to the absence of available information on a timely basis. Allowing a practical exception will provide preparers relief from making difficult and highly subjective fair value estimates each reporting period, yet ensure changes in fair value are recognised when there is clear evidence of a change or impairment. This exception will provide more practical relief than the narrow situations in IFRS 9 where cost may be an appropriate estimate of fair value for investments for unquoted equity instruments. Furthermore, such an exception would be consistent with that proposed in the FASB classification and measurement ED.

Interaction with FASB proposals

The FASB issued its exposure draft in February 2013. In addition to the different timetables to provide comments to each Board, the FASB exposure draft covers a comprehensive classification and measurement model. As such, we may have additional feedback to share with the Board as a result of our consideration of the FASB proposals. We urge the IASB and the FASB to work together in their re-deliberations to reduce differences in their models, including in the wording and application guidance proposed by each Board, and to prevent new differences that may arise in response to constituent feedback.

If you have any questions, please contact John Hitchins, PwC Global Chief Accountant (+44 207 804 2497) or Gail Tucker (+44 117 923 4230).

Yours sincerely

PricewaterhouseCoopers

PricewaterhouseCoopers

Appendix

Question 1:

Do you agree that a financial asset with a modified economic relationship between principal and consideration for the time value of money and the credit risk could be considered, for the purposes of IFRS 9, to contain cash flows that are solely payments of principal and interest? Do you agree that this should be the case if, and only if, the contractual cash flows could not be more than insignificantly different from the benchmark cash flows? If not, why and what would you propose instead?

We agree that a financial asset with a modified economic relationship between principal and consideration for the time value of money and the credit risk could be considered, for the purposes of IFRS 9, to contain cash flows that are solely payments of principal and interest (SPPI).

As stated in our cover letter, we believe that the modified economic relationship test provides a structured approach to assess whether the cash flows of an instrument represent SPPI. However, we believe that a threshold based on a 'significant difference' rather than on a 'more than insignificant difference' is a more appropriate way to articulate the threshold and should be easier to translate around the world.

Since the ED provides latitude for the SPPI criteria in the areas of interest rate reset features and leverage, we believe the Board should also consider similar latitude in assessing prepayment and extension options. The guidance in IFRS 9 identifies specific contingent triggers for prepayment or extension options that would not preclude an instrument from meeting SPPI. However, we note that many instruments permit or require prepayment due to triggers not included in the standard but where the nature of the contingency itself may still be considered related to the time value of money or credit risk, such as when specific assets of the borrower are sold. We believe that financial assets including contingent triggers where the contingency relates to the time value of money or credit risk should meet the SPPI criteria if they accelerate the collection of contractually specified cash flows that would otherwise meet the SPPI test.

We also suggest the Board provide clarity around whether financial assets acquired at a discount or premium that include a prepayment option can meet the SPPI criteria, since the amount funded may be different than the contractual amount to be repaid. In our view, the contractual features of an instrument are established at the inception of the instrument and therefore cannot change based on the timing of acquisition. Thus, we believe that if the terms of the instrument on origination represent SPPI, we believe the instrument continues to meet the SPPI criteria, even if it is subsequently purchased at a discount or premium (which may arise for example in a business combination). In some cases, the pricing of the purchased instrument might reflect the current credit risk associated with the instrument which may be different than the price at origination. If the prepayment above the discount represents a recovery of the credit loss expected on the instrument, the instrument should not be in conflict with the SPPI test. Furthermore, for those entities that manage originated and purchased instruments in the same portfolio, distinguishing between originated and purchased loans for accounting purposes would add complexity to the accounting model and involve system challenges. We suggest the Board clarify the definition of principal when assessing prepayment options to ensure that financial assets with prepayment options that are purchased at a discount or premium pass the SPPI test.

Question 2:

Do you believe that this Exposure Draft proposes sufficient, operational application guidance on assessing a modified economic relationship? If not, why? What additional guidance would you propose and why?

We agree with the Board's response to address the concerns of preparers in applying the current requirements in IFRS 9 to instruments with interest rate mismatch features and leverage. However, we believe that the application guidance on assessing a modified economic relationship should be clarified. As described in question one, we suggest changing the threshold for the test to assess differences in cash flows that are 'significant' rather than 'more than insignificant'.

In January 2013, the IFRS Interpretations Committee (IFRS IC) discussed the presentation of negative interest in the statement of comprehensive income. As the IFRS IC was concerned that finalising the tentative agenda decision could have unintended consequences on the classification of financial assets in accordance with IFRS 9, they refrained from finalising the agenda decision until the Board completes its re-deliberations on the ED. We urge the Board to address the issue of negative interest in the context of IFRS 9 as it is currently unclear whether negative interest is considered 'interest' for SPPI purposes.

Question 3:

Do you believe that this proposed amendment to IFRS 9 will achieve the IASB's objective of clarifying the application of the contractual cash flow characteristics assessment to financial assets that contain interest rate mismatch features? Will it result in more appropriate identification of financial assets with contractual cash flows that should be considered solely payments of principal and interest? If not, why and what would you propose instead?

Generally, we agree the modified economic relationship test will achieve the objective of clarifying the application of the contractual cash flow characteristics assessment to many financial assets that contain interest rate mismatch features. However, we believe the application guidance should be further clarified.

As noted in our cover letter, we acknowledge that some are concerned that the modified economic relationship test may be problematic for instruments in certain jurisdictions where the mechanism of resetting the interest rate is the same for all instruments regardless of the remaining maturity of the instrument. If such a mechanism represents the only permitted pricing basis available for this type of instrument in a particular jurisdiction and the underlying economics of the instrument are structured to otherwise compensate for time value of money and the credit risk of the borrower, it should not preclude the instrument from meeting the SPPI criteria. We recommend that the Board clarify that if such instruments are in the scope of the modified economic relationship test, the 'benchmark' for such extensively regulated instruments should reflect the fact there is only one permitted pricing basis for those instruments, rather than a theoretical instrument that could not exist in practice in the particular economic environment. However, if in the relevant jurisdiction, similar instruments are (or subsequently become) available on other pricing bases (for example, a periodic reset to a rate that reflects the remaining time to maturity of the loan), the modification test would be relevant and the benchmark instrument should include the pricing basis that reflects the remaining time to maturity.

Question 4:

Do you agree that financial assets that are held within a business model in which assets are managed both in order to collect contractual cash flows and for sale should be required to be measured at fair value through OCI (subject to the contractual cash flow characteristics assessment) such that:

a) interest revenue, credit impairment and any gain or loss on derecognition are recognised in profit or loss in the same manner as for financial assets measured at amortised cost; and

b) all other gains and losses are recognised in OCI?

If not, why? What do you propose instead and why?

We agree that financial assets that are held within a business model in which assets are managed both in order to collect contractual cash flows and for sale should be required to be measured at FVOCI, subject to our comment on allowing for an unrestricted FVPL option. We also support the step towards convergence in the area of debt investments with the proposals in the FASB classification and measurement ED.

As stated in our cover letter, we believe that the difficulties identified by constituents in preparing to implement IFRS 9 demonstrate that the two measurement categories that currently exist in IFRS 9 are too limited to allow entities to properly reflect the varied range of business models applied in practice. In addition, this third category is particularly important since the Board, as part of these amendments, is clarifying the business model for financial assets that are held to collect the contractual cash flows, which may result in a narrower AC category than some constituents had originally interpreted the IFRS 9 requirements.

For financial assets that meet the criteria for FVOCI, we agree with having a profit or loss profile that is the same as financial assets measured at AC with all other changes recognised in other comprehensive income. This provides users with relevant information that is consistent with the business model for those financial assets (for example, holding to collect and to sell includes both amortised cost and fair value information). In addition, we believe that it would be useful to disclose amortised cost information in the notes for financial assets measured at FVOCI, since profit or loss arises from amortised cost information and this should be readily available.

For some entities, the overall business model requires the entity to broadly match its assets with its liabilities. Reflecting similar economics between the assets and liabilities is fundamental to how the business and its risks are not only managed but also analysed by users. The insurance industry is a prime example of this. One of the reasons for the proposed limited amendments to IFRS 9 was to consider the interaction of the classification and measurement model for financial assets with the IASB's Insurance Contracts project. We agree that the introduction of the FVOCI measurement category for certain debt instruments will reduce accounting mismatches if changes in discount rates on insurance contract liabilities are recognised in other comprehensive income. However, many insurance entities manage their liabilities with other investments, such as derivatives, non SPPI debt instruments, equities and properties. Whilst the proposed amendments to IFRS 9 will reduce accounting mismatches if insurers invest in certain debt instruments, we are concerned that some insurers will continue to have significant accounting mismatches under the proposed models. We urge the Board to consider the existence of such mismatches further as it finalises the insurance project.

Question 5:

Do you believe that the Exposure Draft proposes sufficient, operational application guidance on how to distinguish between the three business models, including determining whether the business model is to manage assets both to collect contractual cash flows and to sell? Do you agree with the guidance provided to describe those business models? If not, why? What additional guidance would you propose and why?

We believe the ED provides appropriate application guidance on how to distinguish between the hold to collect business model and the hold to collect and sell business model. We note, however, that judgment will be required when assessing terms such as 'infrequent' and 'insignificant' and hence different interpretations may develop in practice.

We suggest clarifying the dividing lines between the FVOCI and FVPL categories. In particular, the concepts of 'maximising returns' (in a FVOCI business model, B4.1.4B) and 'maximising cash flows' (in a FVPL business model, B4.1.5) may be hard to distinguish in practice. In both cases, there is evidence that the entity is managing the fair value of the financial asset to make a profit. The difference seems to be that FVOCI also includes financial assets that are being held to collect the cash flows. We suggest the Board clarify these objectives and include examples in the application guidance to better contrast the FVOCI and FVPL categories.

We also believe there are questions around the level at which to test the entity's business model, for example where there are different activities within a portfolio of financial assets. We suggest the Board consider whether the FASB's description of how to assess the business model is clearer: 'The classification of a financial asset is determined at recognition by the entity's key management personnel on the basis of how the asset will be managed together with other assets within a distinct business model.'

Lastly, paragraph B4.1.6 notes that 'managed on a fair value basis' does not qualify for a hold to collect and to sell business model. However, it seems that there could be portfolios that are both managed on a fair value basis and held to collect. For example, financial assets may be managed and evaluated on a fair value basis in order to manage changes to net assets or to achieve a certain yield, but the entity may not view this portfolio as only holding to sell (and hence only qualify for FVPL measurement). We recommend the Board clarify the interaction of the notion of 'managed on a fair value basis' and the basic hold to collect and sell business model.

Question 6:

Do you agree that the existing fair value option in IFRS 9 should be extended to financial assets that would otherwise be mandatorily measured at fair value through OCI? If not, why and what would you propose instead?

Whilst we are supportive of extending the option to financial assets that would otherwise be mandatorily measured at FVOCI in the case of an accounting mismatch, our preference is for the Board to provide an unrestricted fair value option to measure any financial asset at FVPL. As stated in

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our cover letter, the ability to carry any financial asset at fair value is important to many entities, particularly in the financial services sector. We believe that an unrestricted option will be useful for many entities that may not want to apply complex hedge accounting rules or for entities that prefer to carry their investments at FVPL in those circumstances where it might yield more decision-useful information to investors but when such investments might otherwise mandatorily meet the criteria for FVOCI or AC.

We note an unrestricted fair value option would be consistent with the fact that FVPL is considered the residual category in IFRS 9. Whilst there has been some concerns raised by regulators in the past, on balance, we believe this unrestricted option will enable preparers to select a fair value measurement basis in circumstances where it provides more decision-useful information to investors. The election for the fair value option should be transparent and properly disclosed in the financial statements.

Question 7:

Do you agree that an entity that chooses to early apply IFRS 9 after the completed version of IFRS 9 is issued should be required to apply the completed version of IFRS 9 (i.e. including all chapters)? If not, why? Do you believe that the proposed six-month period between the issuance of the completed version of IFRS 9 and when the prohibition on newly applying previous versions of IFRS 9 becomes effective is sufficient? If not, what would be an appropriate period and why?

We agree that entities should apply the completed version of IFRS 9 if they choose to early adopt IFRS 9. We believe the six-month period between the issuance of the completed version of IFRS 9 and when the prohibition on newly applying previous versions of IFRS 9 becomes effective is sufficient. We refer to question 9 for our considerations for first-time adopters of IFRS.

As described above, for some entities, reflecting the economic linkage between assets and liabilities is fundamental to how the business is managed, as well as analysed by users. For insurance entities, the difference in timing between the new insurance contracts standard and IFRS 9 will inevitably cause challenges as it appears that there will be a lag between the effective date of IFRS 9 and the completion date of the insurance standard. Whilst insurance entities could adopt IFRS 9 based on the existing standard for insurance liabilities (or based on their expectation of the direction the insurance proposals will take), in reality that linkage between the assets and liabilities is so intertwined that it will need to be revised once the new accounting model for insurance contracts is introduced. Accordingly, we suggest a practical solution to allow entities that issue insurance contracts a second opportunity to revisit the decisions in adoption of IFRS 9 when the final insurance standard becomes effective. This will allow for a more holistic view of how the entity issuing insurance contracts manages its business and will provide enhanced information to users of the financial statements.

Question 8:

Do you agree that entities should be permitted to choose to early apply only the 'own credit' provisions in IFRS 9 once the completed version of IFRS 9 is issued? If not, why and what do you propose instead?

We note that constituents continue to be concerned with recognising changes in own credit risk in profit or loss. We also note that users do not understand the counterintuitive result produced by reflecting gains in profit or loss when there is evidence the entity is underperforming.

Accordingly, we agree that entities should be allowed to early adopt the 'own credit' provisions in IFRS 9 not only once the completed version of IFRS 9 is issued, but also for entities applying IAS 39 before the complete version of IFRS 9 is issued. In light of the concerns raised, we recommend the Board consider the most expeditious way for entities to adopt these provisions, whether that is by amending either existing IAS 39 or IFRS 9 (2010) or both.

Question 9:

Do you believe there are considerations unique to first-time adopters that the IASB should consider for the transition to IFRS 9? If so, what are those considerations?

If an entity is required to transition to IFRS after the six-month window has lapsed but before the standard is effective, they may not have sufficient time to prepare comparatives under IFRS 9. In addition, they may not want to adopt IAS 39 knowing it will subsequently be changing to IFRS 9 shortly thereafter. IFRS 9 currently provides relief from restating comparatives for early adopters depending on the date of adoption before the effective date. Given amendments to the effective date are being proposed, we believe the relief from presenting comparatives should be carried forward to the new effective date.

Additional proposed changes for equity investments:

As stated in our cover letter, we recommend the introduction of a practical exception to measure equity investments without readily determinable fair values at an 'adjusted' cost as well as the introduction of recycling for equity investments with changes presented in FVOCI. We acknowledge these changes will introduce one related source of complexity – impairment. For equity investments classified as FVOCI we believe that much of the difficulty associated with determining the timing of impairment of such instruments could be eliminated if subsequent reversal of impairment losses was permitted. We recommend that all fair value movements below cost should be recognised in the income statement once the impairment event has occurred. Further, we believe what is characterised as an impairment model for equity investments carried at 'adjusted cost' under the FASB's ED is appropriate.