



To:	AOSSG members	Date:	14 November 2011
From:	Christina Ng & Sue Lightfoot	Agenda Item:	7.1
Subject:	Financial Instruments	File:	

Objective

The objective is to share views on recent IASB developments on financial instruments by considering and discussing:

- (a) a presentation on recent IASB developments in the context of AOSSG WG views on the *Financial Instruments Impairment* project;
- (b) a presentation on recent IASB developments in the context of AOSSG views on the *Hedge Accounting* project; and
- (c) other IASB developments on financial instruments that might arise between the date of this memo and the AOSSG November 2011 meeting.

Attachments

Key thoughts of the Financial Instruments Working Group on impairment of financial assets measured at amortised cost (Agenda paper 7.2)

Presentation overheads on the IASB's developments on the *Financial Instruments Impairment* project (to be provided at the AOSSG meeting) (Agenda paper 7.3)

AOSSG comments on IASB Supplementary Document to ED/2009/12 *Financial Instruments: Amortised Cost and Impairment* (Agenda paper 7.4)

Presentation overheads on the IASB's developments on the *Hedge Accounting* project (to be provided at the AOSSG meeting) (Agenda paper 7.5)

AOSSG comments on IASB ED/2010/13 *Hedge Accounting* (Agenda paper 7.6)

AOSSG comments on IASB ED/2011/3 *Mandatory Effective Date of IFRS 9* (Agenda paper 7.7)

Background

Financial Assets Impairment

The IASB has been responding to feedback from constituents that IAS 39 *Financial Instruments: Recognition and Measurement* can be difficult to understand and apply. The Financial Crisis Advisory Group (FCAG), which was established by the IASB and the FASB to consider improvements in financial reporting, identified delayed recognition of losses associated with loans (and other financial instruments) as a primary weakness, among other matters. One of the FCAG's recommendations is to explore alternatives to the IAS 39 incurred loss model that use more forward-looking information. Another of the FCAG's recommendations is to simplify and improve the standards on financial instruments.

In relation to financial asset impairment, the IASB has issued two exposure drafts.

- (a) ED/2009/12 *Financial Instruments: Amortised Cost and Impairment*, issued in November 2009, proposed a new measurement model for amortised cost financial assets that incorporates the assessment of expected credit losses (impairment) at every reporting date. The AOSSG provided its views on ED/2009/12 and those views were discussed at the AOSSG's 2009 and 2010 annual meetings.
- (b) Supplementary Document to ED/2009/12 *Financial Instruments: Amortised Cost and Impairment*, issued in January 2011, which was a joint IASB-FASB proposal document based on suggestions from the Expert Advisory Panel (EAP). The Supplementary Document retained many of the principles from the IASB ED/2009/12 and the FASB's exposure draft *Financial Instruments* and addressed some of the major operational difficulties identified for financial assets managed on an open portfolio basis. The AOSSG provided its views on the Supplementary Document (Agenda paper 7.4)

The IASB and the FASB are now deliberating further developments to the impairment model, which in discussion has been referred to as an "expected but not reported" loss model. The IASB tentatively decided:

- (a) to pursue a model in which the overall objective is to reflect the deterioration in credit quality of financial assets;
- (b) a three-bucket impairment model best reflects the deterioration in credit quality, that is, Bucket 1 contains loans for which no significant additional information is available since inception, Bucket 2 contains loans for which credit loss expectations within a whole portfolio have deteriorated, and Bucket 3 contains loans for which deterioration of credit loss expectations within a specific loan or borrower has occurred;
- (c) all financial assets regardless of credit quality at origination or acquisition are classified in Bucket 1 at inception;
- (d) to develop a principle and indicators for recognising 12 or 24 months of expected losses (Bucket 1) and lifetime expected losses (Bucket 2) becomes appropriate; and
- (e) to focus on robust disclosures to support the principle-based 'expected but not reported' impairment model and to ensure comparability between entities.

The AOSSG Financial Instruments Working Group's preliminary views on the IASB's tentative impairment model will be discussed at the AOSSG 23-24 November 2011 meeting. Refer to Agenda paper 7.2 for a background to the Working Group's preliminary views.

Hedge Accounting

In December 2010, the IASB published ED/2010/13 *Hedge Accounting* to fundamentally revise its general hedge accounting requirements (excluding accounting requirements relating to portfolio hedges) in response to feedback from its constituents and the FCAG to simplify the requirements and improve the decision-usefulness of hedging information for users. The AOSSG provided its views on ED/2010/13 (Agenda paper 7.6). In October 2011, the IASB finalised its *Hedge Accounting* project and plans to publish a Review Draft of the near-final requirements on general hedge accounting by December 2011. The Review Draft is to be made public for 120 days.

At the AOSSG 23-24 November 2011 meeting, the AOSSG Financial Instruments Working Group will present its preliminary views on the IASB's tentative decisions relating to general hedge accounting and IAS 39 macro hedge accounting requirements.

Other

The IASB published ED/2011/3 *Mandatory Effective Date of IFRS 9* in August 2011 to propose a delay in the mandatory effective date of IFRS 9 from 1 January 2013 to 1 January 2015. The AOSSG provided its views on ED/2011/3 (Agenda paper 7.7). At its November 2011 meeting, the IASB tentatively decided to amend the mandatory effective date of IFRS 9 to 1 January 2015, not to require the restatement of comparative-period financial statements for the initial application of the classification and measurement requirements of IFRS 9, and instead, to require modified disclosures on transition from IAS 39 to IFRS 9.

In addition, the IASB will be deliberating the need to reconsider IFRS 9 at its 14-18 November 2011 meeting as a result of FASB's decisions relating to financial instruments measurement and matters relating to the Insurance Contracts project. Significant decisions resulting from this meeting may be discussed at the AOSSG 23-24 November 2011 meeting.

