Accounting Standard **AASB 2005-9**

September 2005

Amendments to Australian Accounting Standards

[AASB 4, AASB 1023, AASB 139 & AASB 132]

Australian Government

Australian Accounting Standards Board

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BASIS FOR CONCLUSIONS ON IAS 39 and IFRS 4
(available to AASB online subscribers or through the IASB)

Australian Accounting Standard AASB 2005-9 *Amendments to Australian Accounting Standards* is set out in paragraphs 1 – 25. All the paragraphs have equal authority.

PREFACE

Standards Amended by AASB 2005-9

This Standard makes consequential amendments to the following Australian Accounting Standards:

1. AASB 4 *Insurance Contracts*;
2. AASB 1023 *General Insurance Contracts*;
3. AASB 139 *Financial Instruments: Recognition and Measurement*; and
4. AASB 132 *Financial Instruments: Disclosure and Presentation*.

These amendments arise from proposals in *Amendments to International Financial Reporting Standards IAS 39* Financial Instruments: Recognition and Measurement *and IFRS 4* Insurance Contracts – *Financial Guarantee Contracts* (August 2005) released by the International Accounting Standards Board and subsequent discussions on the issue.

The ability of entities to claim compliance with International Financial Reporting Standards is not affected by the amendments made by this Standard.

Main Features of this Standard

Application Date

This Standard is applicable to annual reporting periods beginning on or after 1 January 2006 with early adoption permitted for annual reporting periods beginning on or after 1 January 2005.

Main Requirements

Under AASB 4 (issued July 2004) and AASB 1023 (issued July 2004) a contract that requires specified payments to be made to reimburse the holder for a loss it incurs if a specified debtor fails to make payments when due under the original or modified terms of a debt instrument meets the definition of an insurance contract. Such a contract could be a financial guarantee contract, credit insurance contract, letter of credit or credit derivative default contract.

AASB 4 is not consistent with the proposals articulated in the June 2002 Invitation to Comment *Proposed Improvements to IAS* 39 Financial Instruments: Recognition and Measurement, which proposed that AASB 139 deal with all financial guarantees.

In July 2004, the AASB issued Exposure Draft ED 134 *Request for Comment on IASB ED of Proposed Amendments to IAS 39* Financial Instruments: Recognition and Measurement *and IFRS 4* Insurance Contracts – *Financial Guarantee Contracts and Credit Insurance*, which proposed that AASB 139 deal with all financial guarantees.

This Standard has not adopted the changes proposed in ED 134.
Some contracts which might be financial guarantee contracts, credit insurance contracts, letters of credit or credit derivative default contracts may meet both the definition of an insurance contract, under AASB 4 and the definition of a financial guarantee contract under AASB 139.

Where a contract meets the definition of a financial guarantee contract, it is within the scope of AASB 139 and AASB 132, and not within the scope of AASB 1023. However, if an issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts, and has applied to them accounting applicable to insurance contracts, the issuer may elect to apply either AASB 139 and AASB 132 or AASB 1023.

ACCOUNTING STANDARD AASB 2005-9

The Australian Accounting Standards Board makes Accounting Standard AASB 2005-9 *Amendments to Australian Accounting Standards* under section 334 of the *Corporations Act 2001*.

D.G. Boymal
Dated 6 September 2005 Chair – AASB

ACCOUNTING STANDARD AASB 2005-9

AMENDMENTS TO AUSTRALIAN ACCOUNTING STANDARDS

Objective

1. The objective of this Standard is to make amendments to:

   (a) AASB 4 *Insurance Contracts*;

   (b) AASB 1023 *General Insurance Contracts*;

   (c) AASB 139 *Financial Instruments: Recognition and Measurement*; and

   (d) AASB 132 *Financial Instruments: Disclosure and Presentation.*

Application

2. This Standard applies to:

   (a) each entity that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act and that is a reporting entity;

   (b) general purpose financial reports of each other reporting entity; and

   (c) financial reports that are, or are held out to be, general purpose financial reports.

3. This Standard applies to annual reporting periods beginning on or after 1 January 2006.

4. This Standard may be applied to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2006. An entity that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act may apply this Standard to such annual reporting periods when an election has been made in accordance with subsection 334(5) of the Corporations Act. When an entity applies this Standard to such an annual reporting period, it shall disclose that fact.

5. The requirements specified in this Standard apply to the financial report where information resulting from their application is material in accordance with AASB 1031 *Materiality*.

6. This Standard will be registered on the Federal Register of Legislative Instruments together with its Explanatory Statement, in accordance with the *Legislative Instruments Act 2003.*

Amendments to AASB 4

7. Paragraph 4(d) is amended to read as follows:

4 An entity shall not apply this Standard to:

…

(d) *financial guarantee contracts* unless the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, in which case the issuer may elect to apply either AASB 139 and AASB 132 or AASB 1023 to such financial guarantee contracts. The issuer may make that election contract by contract, but the election for each contract is irrevocable;

…

8. A note concerning paragraph 41A is added as follows:

41A [Deleted by the AASB]

9. The following definition of a financial guarantee contract is added to Appendix A:

financial guarantee contract A contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

10. Paragraph B18(g) of Appendix B is amended to read as follows:

B18 The following are examples of contracts that are insurance contracts, if the transfer of insurance risk is significant:

…

(g) credit insurance that provides for specified payments to be made to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due under the original or modified terms of a debt instrument. These contracts could have various legal forms, such as that of a guarantee, some types of letter of credit, a credit derivative default contract or an insurance contract. However, although these contracts meet the definition of an insurance contract, they also meet the definition of a financial guarantee contract in AASB 139 and are within the scope of AASB 132 and AASB 139, not this Standard (see paragraph 4(d)). Nevertheless, if an issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either AASB 139 and AASB 132 or AASB 1023 to such financial guarantee contracts;

…

11. Paragraph B19(f) of Appendix B is amended to read as follows:

B19 The following are examples of items that are not insurance contracts:

…

(f) a credit-related guarantee (or letter of credit, credit derivative default contract or credit insurance contract) that requires payments even if the holder has not incurred a loss on the failure of the debtor to make payments when due (see AASB 139);

…

Amendments to AASB 1023

12. Paragraph 2.2(f) is amended to read as follows:

> **2.2 This Standard does not apply to:**
>
> **…**
>
> **(f)** ***financial guarantee contracts*** **unless the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, in which case the issuer may elect to apply either AASB 139** ***Financial Instruments: Recognition and Measurement*** **and AASB 132** ***Financial Instruments: Disclosure and Presentation*** **or this Standard to such financial guarantee contracts. The issuer may make that election contract by contract, but the election for each contract is irrevocable;**
>
> **…**

13. Paragraph 17(e) of the Appendix is amended to read as follows:

> 17 The following are examples of contracts that are general insurance contracts, if the transfer of insurance risk is significant:
>
> …
>
> (e) credit insurance that provides for specified payments to be made to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due under the original or modified terms of a debt instrument. These contracts could have various legal forms, such as that of a guarantee, some types of letter of credit, a credit derivative default contract or an insurance contract. However, although these contracts meet the definition of an insurance contract, they also meet the definition of a financial guarantee contract in AASB 139 and are within the scope of AASB 132 and AASB 139, not this Standard (see paragraph 2.2(f)). Nevertheless, if an issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either AASB 139 and AASB 132 or this Standard to such financial guarantee contracts;
>
> …

14. Paragraph 18(e) of the Appendix is amended to read as follows:

18 The following are examples of items that are not general insurance contracts:

…

(e) a credit-related guarantee (or letter of credit, credit derivative default contract or credit insurance contract) that requires payments even if the holder has not incurred a loss on the failure of the debtor to make payments when due (see AASB 139);

…

Amendments to AASB 139

15. Paragraphs 2(e) and 2(h) are amended to read as follows:

2. This Standard shall be applied to all types of financial instruments except:

…

(e) rights and obligations arising under (i) an insurance contract as defined in AASB 4 *Insurance Contracts*, other than an issuer's rights and obligations arising under an insurance contract that meets the definition of a financial guarantee contract in paragraph 9, or (ii) a contract that is within the scope of AASB 4 because it contains a discretionary participation feature. However, this Standard applies to a derivative that is embedded in a contract within the scope of AASB 4 if the derivative is not itself a contract within the scope of AASB 4 (see paragraphs 10-13 and Appendix A paragraphs AG27-AG33). Moreover, if an issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either this Standard or AASB 1023 *General Insurance Contracts* to such financial guarantee contracts (see paragraphs AG4 and AG4A). The issuer may make that election contract by contract, but the election for each contract is irrevocable;

…

(h) **loan commitments other than those loan commitments described in paragraph 4. An issuer of loan commitments shall apply AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* to loan commitments that are not within the scope of this Standard. However, all loan commitments are subject to the derecognition provisions of this Standard (see paragraphs 15-42 and Appendix A paragraphs AG36-AG63);**

…

16. AASB 139 paragraph 3 is deleted and a note added as follows:

3. [Deleted by the IASB]

17. Paragraph 4 is amended to read as follows:

4. The following loan commitments are within the scope of this Standard:

(a) **loan commitments that the entity designates as financial liabilities at fair value through profit or loss. An entity that has a past practice of selling the assets resulting from its loan commitments shortly after origination shall apply this Standard to all its loan commitments in the same class;**

(b) **loan commitments that can be settled net in cash or by delivering or issuing another financial instrument. These loan commitments are derivatives. A loan commitment is not regarded as settled net merely because the loan is paid out in instalments (e.g. a mortgage construction loan that is paid out in instalments in line with the progress of construction); and**

(c) **commitments to provide a loan at a below-market interest rate. Paragraph 47(d) specifies the subsequent measurement of liabilities arising from these loan commitments.**

18. In paragraph 9, the definition of a financial liability at fair value through profit or loss is amended, and a heading and a definition of a financial guarantee contract is added after the definition of available-for-sale financial assets as follows:

9. The following terms are used in this Standard with the meanings specified.

…

Definitions of Four Categories of Financial Instruments

A *financial asset or financial liability at fair value through profit or loss* is a financial asset or financial liability that meets either of the following conditions:

(a) It is classified as held for trading. A financial asset or financial liability is classified as held for trading if it is:

…

(iii) a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument); or

…

Definition of a Financial Guarantee Contract

A *financial guarantee contract* is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

19. Paragraph 47 is amended to read as follows:

47. After initial recognition, an entity shall measure all financial liabilities at amortised cost using the effective interest method, except for:

(a) financial liabilities at fair value through profit or loss. Such liabilities, including derivatives that are liabilities, shall be measured at fair value except for a derivative liability that is linked to and must be settled by delivery of an unquoted equity instrument whose fair value cannot be reliably measured which shall be measured at cost;

(b) financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies. Paragraphs 29 and 31 apply to the measurement of such financial liabilities;

(c) financial guarantee contracts as defined in paragraph 9. After initial recognition, an issuer of such a contract shall (unless paragraph 47(a) or (b) applies) measure it at the higher of:

(i) the amount determined in accordance with AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*; and

(ii) the amount initially recognised (see paragraph 43) less, when appropriate, cumulative amortisation recognised in accordance with AASB 118 *Revenue*; and

(d) commitments to provide a loan at a below-market interest rate. After initial recognition, an issuer of such a commitment shall (unless paragraph 47(a) applies) measure it at the higher of:

(i) the amount determined in accordance with AASB 137; and

(ii) the amount initially recognised (see paragraph 43) less, when appropriate, cumulative amortisation recognised in accordance with AASB 118.

Financial liabilities that are designated as hedged items are subject to the hedge accounting requirements in paragraphs 89-102.

20. Notes concerning paragraphs 103A and 103B are added as follows:

103A. [Deleted by the AASB]

103B. [Deleted by the AASB]

21. Paragraph AG4 is renumbered as AG3A. Paragraph AG4A is renumbered as AG4 and amended to read as follows:

AG4. Financial guarantee contracts may have various legal forms, such as a guarantee, some types of letter of credit, a credit default contract or an insurance contract. Their accounting treatment does not depend on their legal form. The following are examples of the appropriate treatment (see paragraph 2(e)).

(a) Although a financial guarantee contract meets the definition of an insurance contract in AASB 4 if the risk transferred is significant, the issuer applies this Standard. Nevertheless, if the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either this Standard or AASB 1023 to such financial guarantee contracts. If this Standard applies, paragraph 43 requires the issuer to recognise a financial guarantee contract initially at fair value. If the financial guarantee contract was issued to an unrelated party in a stand-alone arm's length transaction, its fair value at inception is likely to equal the premium received, unless there is evidence to the contrary. Subsequently, unless the financial guarantee contract was designated at inception as at fair value through profit or loss or unless paragraphs 29-37 and AG47-AG52 apply (when a transfer of a financial asset does not qualify for derecognition or the continuing involvement approach applies), the issuer measures it at the higher of:

    (i) the amount determined in accordance with AASB 137; and

    (ii) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with AASB 118 (see paragraph 47(c)).

(b) Some credit-related guarantees do not, as a precondition for payment, require that the holder is exposed to, and has incurred a loss on, the failure of the debtor to make payments on the guaranteed asset when due. An example of such a guarantee is one that requires payments in response to changes in a specified credit rating or credit index. Such guarantees are not financial guarantee contracts, as defined in this Standard, and are not insurance contracts, as defined in AASB 4. Such guarantees are derivatives and the issuer applies this Standard to them.

(c) If a financial guarantee contract was issued in connection with the sale of goods, the issuer applies AASB 118 in determining when it recognises the revenue from the guarantee and from the sale of goods.

22. Paragraph AG4A is added as follows:

AG4A. Assertions that an issuer regards contracts as insurance contracts are typically found throughout the issuer's communications with customers and regulators, contracts, business documentation and financial report. Furthermore, insurance contracts are often subject to accounting requirements that are distinct from the requirements for other types of transaction, such as contracts issued by banks or commercial companies. In such cases, an issuer's financial report typically includes a statement that the issuer has used those accounting requirements.

Amendments to AASB 132

23. Paragraph 4(d) is amended to read as follows:

4. This Standard shall be applied to all types of financial instruments except:

…

(d) insurance contracts as defined in AASB 4 *Insurance Contracts*. However, this Standard applies to derivatives that are embedded in insurance contracts if AASB 139 requires the entity to account for them separately. Moreover, an issuer shall apply this Standard to financial guarantee contracts if the issuer applies AASB 139 in recognising and measuring the contracts, but shall apply AASB 1023 *General Insurance Contracts* if the issuer elects, in accordance with paragraph 2.2(f) of AASB 1023, to apply AASB 1023 in recognising and measuring them;

…

24. Paragraph 12 is amended to read as follows:

12. The following terms are defined in paragraph 9 of AASB 139 and are used in this Standard with the meaning specified in AASB 139:

…

(f) financial asset or financial liability at fair value through profit or loss;

(g) financial guarantee contract;

(h) firm commitment;

(i) forecast transaction;

(j) hedge effectiveness;

(k) hedged item;

(l) hedging instrument;

(m) held-to-maturity investments;

(n) loans and receivables;

(o) regular way purchase or sale; and

(p) transaction costs.

References to be Updated when an Entity Adopts AASB 7

25. When an entity applies AASB 7 *Financial Instruments: Disclosures*, references to AASB 132 are replaced by references to AASB 7 in the following paragraphs that were added or amended by this Standard:

    (a) AASB 4 paragraph 4(d) and paragraph B18(g) of Appendix B (two references); and

    (b) AASB 1023 paragraph 2.2(f) and paragraph 17(e) of the Appendix (two references).