Regulation Impact Statement

Accounting Standard
AASB 9 *Financial Instruments*

December 2009

Australian Government
Australian Accounting Standards Board

Regulation Impact Statement

AASB 9 *FINANCIAL INSTRUMENTS*

Background

The Australian Accounting Standards Board (AASB) is implementing the Financial Reporting Council's (FRC) directions to:

- adopt International Financial Reporting Standards [the Standards and Interpretations of the International Accounting Standards Board (IASB)] for application to reporting periods beginning on or after 1 January 2005; and
- to harmonise Generally Accepted Accounting Principles (GAAP) and Government Finance Statistics in relation to Government financial reporting.

To put the first of the FRC strategic directions into effect the AASB is issuing Australian Accounting Standards that incorporate IASB Standards and has undertaken a separate project in respect of harmonising GAAP and Government Finance Statistics.

Implementation of the FRC's Year 2005 direction does not, of itself, cause a change in the underlying economic circumstances of an entity but at times results in events and transactions being portrayed differently so as to achieve improvements in the transparency and quality of Australian financial reports.

The AASB has decided to continue to issue one series of transaction-neutral Standards, that is, Standards applicable to transactions whether they take place in for-profit or not-for-profit entities, including public sector entities. The AASB has regard to the Standards of the International Public Sector Accounting Standards Board of the International Federation of Accountants (IPSASB) in respect of issues affecting not-for-profit entities. The IPSASB is using the IASB's Standards, to the extent feasible, as the basis for International Public Sector Accounting Standards (IPSASs). Accordingly, adopting IASB Standards simultaneously helps convergence with existing and future IPSASs.

Except for Standards that are specific to the not-for-profit or public sectors or that are purely of a domestic nature, the AASB is using the IASB Standards as the "foundation" Standards to which it adds material detailing the scope and applicability of a Standard in the Australian environment. Additions are made, where necessary, broadening the content to cover sectors not addressed by an IASB Standard and domestic, regulatory or other issues. The AASB is also undertaking a differential reporting project, which is considering the merits of a reduced disclosure regime for certain entities.

Functions of the FRC include determining the AASB's broad strategic direction, monitoring the development of international standards and the accounting standards that apply in major international financial centres, to further the development of a single set of standards for world-wide use with appropriate regard to international developments and to promote the adoption of international best practice in the Australian accounting standard-setting process.

Both the AASB and the FRC are required to advance the main objects of Part 12 of the ASIC Act, Section 224, to:

- facilitate the development of accounting standards that require the provision of financial information that allows users to make and evaluate decisions about allocating scarce resources, assists directors to discharge their obligations in relation to financial reporting, is relevant to assessing performance, financial position, financing and investment, is relevant and reliable, facilitates comparability and is readily understandable;

- facilitate the Australian economy by reducing the cost of capital, enabling Australian entities to compete effectively overseas and having accounting standards that are clearly stated and easy to understand; and

- maintain investor confidence in the Australian economy (including its capital markets).

It is in this context that the FRC has decided to direct the AASB to adopt IASB Standards with effect from I January 2005.

New Accounting Standard

AASB 9 *Financial Instruments* is part of the set of Australian Accounting Standards that incorporate IASB standards, and in particular, incorporates the IASB's IFRS 9 *Financial Instruments*.

The issue of AASB 9 is consistent with section 227(1) of the *Australian Securities and Investments Commission Act 2001* (ASIC Act), which identifies the functions of the AASB as being to:

- develop a conceptual framework, not having the force of an accounting standard, for the purpose of evaluating proposed accounting standards and international standards;

- make accounting standards under section 334 of the *Corporations Act* for the purposes of the corporations legislation;

- formulate accounting standards for other purposes; and
- participate in and contribute to the development of a single set of accounting standards for world-wide use having regard to the interests of Australian corporations that raise or propose to raise capital in major international financial centres.

1. Problem Addressed

Accounting Standard AASB 139 *Financial Instruments: Recognition and Measurement* incorporates International Accounting Standard IAS 39 *Financial Instruments: Recognition and Measurement.*

In light of the financial crisis experienced globally over the past 18 months, the IASB was criticised for some of the requirements in IAS 39. As a result, the Group of Twenty (G-20) Finance Ministers and Central Bank Governors called for the IASB to simplify and improve accounting for financial instruments. As part of this process, the IASB commenced a number of projects and accelerated the completion timeframes for other projects to improve IAS 39 and related requirements. The issuance of IFRS 9 is part of phase I of the IASB's project to replace IAS 39. IFRS 9 applies to the classification and measurement of financial assets. The IASB will address the classification and measurement of financial liabilities, as well as impairment of financial assets and hedging, as part of other phases of the IASB's project to replace IAS 39.

If IFRS 9 is not adopted in Australia, Australian requirements would not contain the improvements made by the IASB and the FRC direction would not be met.

2. Objectives

The AASB's objectives in addressing the problem are to simplify, in the same way as being achieved globally, the requirements in respect of financial assets and to improve the quality and usefulness of financial asset information that is reported in Australia in respect of entities in the private and public sectors and to implement the FRC's directions.

3. Options

Option 1

Adopt IFRS 9 – improves financial reporting requirements and enables compliance with the FRC direction.

Option 2

Not adopt IFRS 9 and retain the requirements in AASB 139 for financial assets – would mean that there would not be an Australian Standard equivalent to IFRS 9. This would be inconsistent with the FRC's direction relating to adoption of IASB Standards and would lose the benefits of simplification and improvement.

4. Impact Analysis

4.1 ***Affected Parties***

In the process of setting accounting standards, the AASB issues Exposure Drafts and Invitations to Comment to consult with stakeholders. Comments received from constituents are taken into account in developing the standards.

When issuing Exposure Drafts of Australian Accounting Standards that incorporate IASB Standards, the AASB specifically seeks comment from constituents on whether the proposals are in the best interests of the Australian economy and on whether there are regulatory or other issues that may affect the implementation of the proposals.

Parties likely to be most directly affected by the Standard are:

(a) reporting entities required to prepare general purpose financial reports and that hold financial assets;

(b) users of reports identified in (a) such as:

- (i) resource providers (including fund managers, investors, creditors and employees);
- (ii) participants in the Australian capital markets;
- (iii) parties performing a review or oversight function (including analysts, ASIC and ASX); and
- (iv) management and governing bodies (including use of these reports in the discharge of accountability).

The wider community affected by the efficiency of the Australian capital markets and their reputation inside Australia and overseas are likely to be indirectly or less directly affected by the Standard.

4.2 *Effect on Existing Regulations*

AASB 9 is applicable to annual reporting periods beginning on or after 1 January 2013. However, it may be applied to annual reporting periods ending on or after 31 December 2009 that begin before 1 January 2013. Therefore, the impact of issuing a revised AASB 9 will result in Regulation not being operative until annual reporting periods beginning on or after 1 January 2013 unless early adopted. This long lead time provides relief from the task of transitioning to the new Standard.

4.3 *Costs and Benefits*

The AASB assesses from a public interest perspective whether the costs of providing certain financial information exceed the benefits to be derived from its provision. There is no universally accepted methodology for quantitatively measuring costs and benefits of information presented in financial reports. The costs of providing financial information are incurred, in the main, by reporting entities, but extend in various direct and indirect ways to the users of general purpose financial statements. In this context, the AASB is often guided by the feedback received from constituents as to the costs that may be involved in implementing newly issued accounting requirements. This feedback is both from the AASB's due process and also from the IASB's due process. For example, entities are likely to incur one-off costs in the transition to implement any systems changes and their review for external audit purposes. However, there is no guarantee that the costs are borne ultimately by those who derive the benefits. The AASB considers the benefits and costs for individual Standards in the context of the Year 2005 direction as a whole.

AASB 9 will have an impact on current Australian practice. AASB 9 will simplify accounting for financial assets. However, there is expected to be initial implementation costs and there may be instances where additional costs are incurred in applying some of the revised requirements. For example, the removal of the cost exemption for investments in equity instruments where the fair value could not be measured reliably means that all investments in equity instruments will need to be measured at fair value. However, in order to relieve some of the costs associated with determining fair value of equity instruments, the guidance to AASB 9 notes that there may be certain circumstances where cost may be representative of fair value. The extended transition provisions also enable preparers to judge when it is most economical for them to adopt the new Standard.

5. Consultation

The AASB issued Exposure Draft ED 184 *Financial Instruments: Classification and Measurement* in July 2009. ED 184 reproduced the proposals included in the IASB's Exposure Draft ED/2009/7 *Financial Instruments: Classification and Measurement* without amendment.

The AASB invited comments from Australian constituents on the proposals regarding the classification and measurement of financial instruments, as well as the consequential amendments to other Australian Accounting Standards that would result from the issuance of a Standard based on the proposals. The AASB received nine written submissions from Australian constituents. Submissions received were generally supportive of the proposals. However, a number of constituents expressed concerns regarding the proposal to recognise dividends in other comprehensive income when an entity elected to present fair value changes for an investment in an equity instrument in other comprehensive income and the proposal to remove the cost exemption for investments in equity instruments where the fair value could not be measured reliably.

In its submission to the IASB, the AASB noted the concerns expressed by constituents. The IASB addressed the concerns by requiring dividends that are 'returns on investment', for investments in equity instruments that are not held for trading, to be recognised in profit or loss. The IASB also clarified that in certain circumstances, cost may be representative of fair value.

6. Conclusion and Recommendation

The AASB decided to adopt Option 1 and issue AASB 9. In forming this conclusion, the AASB considered that, on balance, the benefits of simplified requirements and improved financial reporting of financial assets outweighed the costs to individual entities of adopting AASB 9. The Board also noted that adoption of the revised accounting requirements for financial assets will facilitate the Australian economy by reducing the cost of capital, enabling entities to compete effectively overseas and providing information that is relevant, reliable and facilitates comparability. Adoption of Option 1 also eliminated the possibility of the significant indirect costs that Australia would face if it no longer could claim compliance with IFRS.

7. Implementation and Review

The IASB has expressed its intention to expose the requirements that are to be developed by the United States Financial Accounting Standards Board regarding the accounting for financial instruments, which is not being undertaken in stages. Therefore, AASB 9 will be subject to review and revision taking account of international developments, particularly by the IASB, changes to the Corporations Law and Regulations and the experience of constituents in implementing the Standard.