Explanatory Statement

Accounting Standard AASB 2010-7
Amendments to Australian Accounting Standards arising from AASB 9 (December 2010)

December 2010

Australian Government

Australian Accounting Standards Board

EXPLANATORY STATEMENT

Standards Amended by AASB 2010-7

This Standard makes amendments to the following Australian Accounting Standards (including Interpretations):

1. AASB 1 *First-time Adoption of Australian Accounting Standards*;
2. AASB 3 *Business Combinations*;
3. AASB 4 *Insurance Contracts*;
4. AASB 5 *Non-current Assets Held for Sale and Discontinued Operations*;
5. AASB 7 *Financial Instruments: Disclosures*;
6. AASB 101 *Presentation of Financial Statements*;
7. AASB 102 *Inventories*;
8. AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*;
9. AASB 112 *Income Taxes*;
10. AASB 118 *Revenue*;
11. AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance*;
12. AASB 121 *The Effects of Changes in Foreign Exchange Rates*;
13. AASB 127 *Consolidated and Separate Financial Statements*;
14. AASB 128 *Investments in Associates*;
15. AASB 131 *Interests in Joint Ventures*;
16. AASB 132 *Financial Instruments: Presentation*;
17. AASB 136 *Impairment of Assets*;
18. AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*;

19. AASB 139 *Financial Instruments: Recognition and Measurement*;

20. AASB 1023 *General Insurance Contracts*;

21. AASB 1038 *Life Insurance Contracts*;

22. Interpretation 2 *Members' Shares in Co-operative Entities and Similar Instruments*;

23. Interpretation 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*;

24. Interpretation 10 *Interim Financial Reporting and Impairment*;

25. Interpretation 12 *Service Concession Arrangements*;

26. Interpretation 19 *Extinguishing Financial Liabilities with Equity Instruments*; and

27. Interpretation 127 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*.

These amendments arise from the issuance of AASB 9 *Financial Instruments* as issued in December 2010.

Main Features of this Standard

Application Date

This Standard applies to annual reporting periods beginning on or after 1 January 2013. Earlier application is permitted from:

(a) any date between 6 December 2010 and 31 December 2010, for entities initially applying this Standard before 1 January 2011; or

(b) the beginning of the first reporting period in which the entity adopts this Standard, for entities initially applying this Standard on or after 1 January 2011.

However, if an entity elects to apply this Standard early and has not already applied AASB 9 and AASB 2009-11 *Amendments to Australian Accounting Standards arising from AASB 9* issued in December 2009, it must apply all of the requirements in AASB 9 (as issued in December 2010) at the same time. If an entity applies this Standard in its financial statements for a period beginning before 1 January 2013, it shall disclose that fact.

When applied or operative, this Standard supersedes the changes made by AASB 2009-11 *Amendments to Australian Accounting Standards arising from AASB 9* issued in December 2009. However, for annual reporting periods ending on or after 31 December 2009 that begin before 1 January 2013, an entity may elect to apply AASB 9 issued in December 2009 instead of applying AASB 9 (as issued in December 2010) and therefore would apply the amendments to other Australian Accounting Standards in AASB 2009-11 instead of the amendments to other Australian Accounting Standards in AASB 2010-7.

Main Requirements

This Standard gives effect to consequential changes arising from the re-issuance of AASB 9. The Preface to AASB 9 (as issued in December 2010) summarises the main requirements of that Standard.

Consultation Prior to Issuing AASB 2010-7

Prior to issuing AASB 9 in December 2010, extensive consultation took place on the derecognition requirements for financial instruments and the recognition and measurement requirements for financial liabilities (see Appendix 1 for detailed analysis of consultation).

The amendments to other Australian Accounting Standards in AASB 2010-7 arise from the reissuance of AASB 9 in December 2010. In reissuing AASB 9 (December 2010), the derecognition requirements for financial instruments and the recognition and measurement requirements for financial liabilities were transferred from AASB 139.

The only change to those requirements is that the portion of a change of fair value relating to the entity's own credit risk for financial liabilities measured at fair value utilising the fair value option is required to be separately presented in other comprehensive income, except when that would create or enlarge an accounting mismatch. If such a mismatch would be created or enlarged, the entity is required to present all changes in fair value (including the effects of changes in the credit risk of the liability) in profit or loss. There were no changes to the main recognition and measurement requirements for financial liabilities.

Accordingly, a Regulation Impact Statement has not been prepared in connection with the issue of AASB 2010-7 as the amendments made do not have a substantial direct or indirect impact on business or competition, are of a minor or machinery nature or clarify existing requirements.

Appendix – Further detail on Consultation Prior to Issuing this Standard

The AASB issued Exposure Draft ED 177 *Derecognition (Proposed Amendments to AASB 139 and AASB 7)* that incorporated the IASB's ED/2009/3 *Derecognition* and which proposed amendments to the requirements for derecognition of financial assets in IAS 39.

The ED proposed a new derecognition approach that would have been similar to the derecognition approach in IAS 39 in that:

(a) it proposed the same criteria for when a transferred part of a financial asset qualifies to be assessed for derecognition;

(b) it proposed a test of control (although unlike IAS 39 that test has primacy); and

(c) many of the derecognition outcomes would have been similar.

However, the proposed approach was different from IAS 39 in that it did not combine elements of several derecognition concepts but rather focused on a single element – control. As a result, unlike IAS 39, the proposed approach did not have:

(a) a test to evaluate the extent of risks and rewards retained;

(b) specific pass-through requirements; or

(c) a requirement for a transferor (in a transfer that fails derecognition) to recognise and measure a financial asset to the extent of its continuing involvement.

A large minority of the IASB's members included an alternative approach in the ED. Like the proposed approach, the alternative approach based the decision of whether an entity should derecognise a transferred financial asset on whether the entity has surrendered control of the asset. However, unlike the proposed approach, the alternative approach assessed control differently, and with that, had a different perspective on the asset that is the subject of the transfer.

The ED also proposed amendments to IFRS 7 *Financial Instruments: Disclosures* that would enhance disclosures to improve the evaluation of risk exposures and performance in respect of an entity's transferred financial assets.

The AASB received six written submissions from Australian constituents. Submissions received were generally supportive of the proposals. However, significant concerns were expressed regarding the complexity of the topic and whether the IASB would have enough time to consider all necessary issues on its ‘fast-track’ timetable.

The AASB considered both the proposed and alternative approaches. Whilst the AASB expressed support for some aspects of the proposed approach in the ED, overall, the AASB favoured the alternative approach because it is more consistent with the Conceptual Framework. However, the AASB noted that the IASB needed to further develop the alternative approach to consider possible implications of its application and develop application guidance.

The IASB received a number of submissions in support of the alternative approach in that it appeared much simpler and less subject to structuring. As a result, the IASB decided that more work was required and that the recognition and measurement reforms could not be completed within the original timeframe. Accordingly, the IASB decided to only promulgate the disclosure amendments to IFRS 7 around derecognition of financial assets.

In respect of the classification and measurement requirements for financial assets and financial liabilities, the AASB issued Exposure Draft ED 184 *Classification and Measurement* in April 2009 that incorporated the IASB’s Exposure Draft ED/2009/7 *Classification and Measurement* without amendment. The AASB received nine written submissions from Australian constituents. Submissions received were generally supportive of the proposals. However, a number of constituents expressed concerns that the recognition and measurement requirements in respect of financial liabilities in IAS 39 were fine, and all that was required is for the IASB to address the impact of credit risk.

Around the time that ED 184 was published, a Discussion Paper on the role of credit risk in liability measurement (commonly referred to as ‘own credit risk’), together with a summary paper that described the most common arguments for and against including credit risk in measuring liabilities were published. The Discussion Paper asked whether current measurements of liabilities (including fair value) should incorporate the probability that an entity will fail to perform as required and, if not, what the alternatives are. The paper summarised three possible approaches to measure liabilities while excluding own credit risk.

The AASB responded to the Discussion Paper, noting that none of the approaches were appropriate if the measurement attribute was to be fair value. The AASB recommended that the IASB not mix measurement attributes – that is, not allow a financial liability to be measured at fair value without considering the impact of credit risk.

The IASB redeliberated and in responding to concerns about the impact of credit risk on financial liabilities designated at fair value through profit or loss, issued Exposure Draft ED/2010/4 *Fair Value Option for Financial Liabilities*. The AASB issued Exposure Draft ED 196 *Fair Value Option for Financial Liabilities* in May 2010, which incorporated the IASB's ED/2010/4. The main proposals of ED/2010/4 were to:

(a) present fair value gains or losses that arise from changes in credit risk on financial liabilities that are designated at fair value through profit or loss in other comprehensive income (OCI); and

(b) retain the other existing IAS 39 accounting for financial liabilities.

The AASB invited comments from Australian constituents on the proposals, as well as the consequential amendments to other Australian Accounting Standards that would result from the issuance of a Standard incorporating the proposals.

The AASB received ten written submissions from Australian constituents. Submissions received were generally supportive of the proposals. In its submission to the IASB, the AASB expressed its concerns regarding the proposal to use a two-step approach to recognise changes in fair value due to changes in own credit risk in OCI and the appropriateness of the guidance in IFRS 7 *Financial Instruments: Disclosures* to determine the change in fair value associated with own credit risk.

The IASB addressed the concerns by requiring the change in fair value to be presented directly in OCI in one-step. The IASB also clarified that the guidance in IFRS 7 would be retained for determining the change in fair value due to change in own credit risk, but that an entity may use another method where it more accurately measures the change.