

Explanatory Statement

Accounting Standard AASB 9 *Financial Instruments*

December 2014



Australian Government

**Australian Accounting
Standards Board**

EXPLANATORY STATEMENT

Reasons for Issuing AASB 9

The International Accounting Standards Board (IASB) has issued IFRS 9 *Financial Instruments* to apply to annual reporting periods beginning on or after 1 January 2018, with earlier application permitted. The AASB is issuing AASB 9 *Financial Instruments* to enable Australian reporting entities to continue to be compliant with International Financial Reporting Standards in relation to accounting for Financial Instruments.

Main Features of AASB 9

Main Requirements

AASB 9 *Financial Instruments* requires that entities recognise impairment losses on financial assets on an expected basis rather than an incurred basis and introduces a fair value through other comprehensive income (FVOCI) category for non-equity financial assets.

The consequential amendments arising from AASB 9 also amend the existing disclosures set out in AASB 7 *Financial Instruments: Disclosures* in relation to impairment and classification and measurement of financial assets.

Impairment

The approach in AASB 9 is that, in general, if the credit risk on a loan asset (or portfolio of loan assets) has not increased significantly since initial recognition, an entity must recognise a loss allowance for that asset (or portfolio of assets) at an amount equal to the '12-month expected credit losses'. The 12-month expected credit losses are the portion of lifetime expected credit losses that represent the credit losses expected to result from default events on a loan asset (or portfolio of loan assets) that are possible within the 12 months after the reporting date. [For example, 12-month expected credit losses would include the credit losses expected to result from a rise in unemployment that is considered likely to occur over the next 12 months.]

In general, if the credit risk of a loan asset (or portfolio of loan assets) has increased significantly since initial recognition, an entity must recognise a loss allowance for that asset (or portfolio of assets) at an amount equal to the 'lifetime expected credit losses'. In making that determination, the entity needs to consider all reasonable and supportable information, including forward-looking information. Lifetime expected credit losses are the credit losses expected to result from all possible default events over the expected life of a loan asset (or portfolio of loan assets). [For example, lifetime expected credit losses would include the credit losses expected to result from a rise in unemployment that is considered likely to occur over the life of the loans held.]

Credit losses (impairments) are recognised as expenses in profit or loss, and reversals of credit losses (impairments) are recognised as gains in profit or loss.

Entities need to determine whether or not there are significant increases in credit risk by comparing the risk of a default occurring on the loan asset (or the portfolio of loan assets) as at the reporting date with the risk of a default occurring as at the date of initial recognition. In doing this, an entity must consider reasonable and supportable information, that is available without undue cost or effort, and that is indicative of significant increases in credit risk since initial recognition.

Classification and measurement

AASB 9 also effectively reinstates a fair value through other comprehensive income (FVOCI) category for classification and measurement of non-equity financial assets.

Application Date

AASB 9 applies to annual reporting periods beginning on or after 1 January 2018. Earlier application is permitted for annual reporting periods beginning on or after 1 January 2005 but before 1 January 2018.

Consultation Prior to Issuing this Standard

In the process of developing AASB 9, the AASB published the following consultation documents for public comment (which were based on similar consultation documents issued internationally by the IASB):

- (a) Exposure Draft ED 189 *Financial Instruments: Amortised Cost and Impairment (proposed amendments to AASB 7 and AASB 139)* in November 2009, which incorporated the IASB Exposure Draft ED/2009/12 (of the same title);
- (b) Exposure Draft ED 210 *A Supplement to ED 189* in February 2011, which incorporated the IASB Exposure Draft *A Supplement to ED/2009/12*;

- (c) Exposure Draft ED 230 *Classification and Measurement: Limited Amendments to AASB 9* in December 2012, which incorporated the IASB Exposure Draft ED/2012/4 (of the same title); and
- (d) Exposure Draft ED 237 *Financial Instruments: Expected Credit Losses* in March 2013, which incorporated the IASB Exposure Draft ED/2013/3 (of the same title).

A draft RIS was not prepared to accompany any of these Exposure Drafts. However, the Exposure Drafts were each accompanied by a Basis for Conclusions that included an outline of the potential benefits and costs of the respective proposals in qualitative terms. Accordingly, constituents were made aware of the IASB's thinking on matters of costs and benefits of the proposals and were provided with ample opportunity to comment on those costs and benefits. Each Exposure Draft issued during the development of the 'completed' version of IFRS 9 also asked constituents whether they wish to raise any Australian-specific issues.

Impairment

There were three formal rounds of consultation as the IASB developed its proposals. The AASB, Australian constituents, and many others from around the world, contributed to their development.

In response to ED 189, which incorporated IASB ED/2009/12, the AASB received seven submissions. The AASB also held roundtable discussions in March 2010 in Melbourne and Sydney that approximately 30 constituents attended.

The ED 189 proposals were generally not supported and various issues were raised for consideration. The AASB considered comments it received in making its submission to the IASB on ED/2009/12 and submitted to the IASB that the IASB's ED/2009/12 proposals are not supportable on both conceptual and practical grounds. Similar comments were made by a wide range of constituents (including other national standards setters) from around the world.

In February 2011 the AASB issued ED 210, which incorporated the IASB Supplementary Exposure Draft, which was an attempt by the IASB to address the weaknesses that had been commented on in respect of ED/2009/12.

Two submissions were received by the AASB and face-to-face meetings conducted with key constituents in respect of the proposals in ED 210 raised various issues for consideration. The AASB considered comments it received in making its submission to the IASB on the Supplement to ED/2009/12.

The AASB expressed concerns about the proposed approach because it employed both the time-proportionate loss method and the foreseeable future loss method and lacked a conceptual basis.

Based on the feedback on ED/2009/12 and on the Supplement to ED/2009/12, the IASB developed completely different proposals for an expected loss model.

In response to ED 237, which incorporated IASB ED/2013/3, the AASB received nine submissions. The AASB also held roundtable discussions in Melbourne and Sydney that approximately 20 constituents attended.

There was general support for the proposals in ED 237, whilst various issues were raised for consideration. The AASB considered comments it received in making its submission to the IASB that expressed the view that while the AASB was not entirely in agreement with the ED/2013/3 proposals, with certain refinements, it could provide a workable solution to the issues being faced.

Classification and Measurement

In response to ED 230, which incorporated IASB ED/2012/4 the AASB received eight submissions. Those submissions generally supported adopting the proposals, whilst raising various issues for consideration. The AASB considered comments it received in making its submission to the IASB on ED/2012/4.

Although concerned about the reversal of the IASB's previous position of not having a FVOCI category for financial instruments in IFRS 9, the AASB broadly supported the proposals in ED/2012/4.

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the
Human Rights (Parliamentary Scrutiny) Act 2011

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Overview of the Accounting Standard

AASB 9 *Financial Instruments* requires that entities recognise impairment losses on financial assets on an expected basis rather than an incurred basis and introduces a fair value through other comprehensive income (FVOCI) category for non-equity financial assets.

The consequential amendments arising from AASB 9 also amend the existing disclosures set out in AASB 7 *Financial Instruments: Disclosures* in relation to impairment and classification and measurement of financial assets.

Human Rights Implications

This Standard is issued by the AASB in furtherance of the objective of facilitating the Australian economy. It does not diminish or limit any of the applicable human rights or freedoms, and thus does not raise any human rights issues.

Conclusion

This Standard is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.