Accounting Standards Board

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Dear Sue

Exposure Draft 'Financial Instruments: Classification and Measurement'

This letter sets out the comments of the UK Accounting Standards Board (ASB) on the above Exposure Draft (ED).

The ASB welcomes the publication of this ED, which we believe simplifies the existing guidance. Our responses to the questions asked in the ED are set out in the Appendix to this letter. Our overarching comments are outlined below:

- We note that the IASB and FASB are at different stages in developing proposals on these issues and appear to be proposing different solutions. We agree that convergence with the FASB is desirable and would address calls for a global set of accounting standards. In particular, it makes sense in the financial instruments arena where global markets exist and where there have been calls by the G20 to improve the standards on financial instruments. However, we believe that it is more important to produce a high quality International Financial Reporting Standard for financial instruments that is workable rather than arriving at a compromised standard for the purpose of achieving convergence.

- We support the use of a mixed measurement model for the measurement of financial instruments proposed in the ED. We believe that having two measurement categories will simplify the requirements of the existing standard and will be a step towards meeting the objective of reducing complexity in reporting financial instruments. We understand that the FASB's tentative decisions indicate that it is considering requiring full fair value measurement for all types of financial instruments. We would not support the inclusion of a full fair value measurement model into IFRS.

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- The ASB believes that some of the guidance proposed for financial instruments held at amortised cost needs improvement to ensure it represents a principle that can be applied consistently for classification, measurement and disclosure of financial instruments across entities. We believe it would be better (and closer to the actual likely application in practice) to give primacy to the business model, and the decisions being made at that level, when considering categorisation of financial instruments acquired as a result of a transaction.

- We consider that fair value in its present form is an appropriate measurement basis for certain financial instruments, although we acknowledge that there can be practical difficulties in establishing fair value in inactive markets. However, classification and measurement of financial instruments is inextricably linked to the outcome of the 'Fair Value Measurement' project. Therefore, it is difficult to conclude on whether fair value would still be appropriate if the method for determining fair value changes.

- The current accounting for embedded derivatives is an area of complexity. However, we are also aware that the removal of the requirement to separately account for embedded derivatives in financial host contracts could mean that more financial instruments are likely to be measured at fair value through profit or loss. We understand the pressures the IASB is under to complete this project as soon as possible. However, as a minimum we would encourage the IASB to perform field testing, as far as is possible given the time constraints facing this project, to try to gauge the extent of increase in fair value usage arising from this change before finalising these requirements. We would also encourage the IASB to conduct a simultaneous review of accounting for embedded derivatives in non-financial host contracts to ensure consistency of the final solution.

- We do not agree with the proposals for prohibiting reclassifications of financial instruments after initial recognition. We are concerned that such prohibition would lead to inappropriate accounting in the event of changes in business model. Instead, we suggest that reclassifications should be permitted in the circumstance of a change in business model with adequate disclosure by the entity giving reasons for the change.

- We have concerns about the practical consequences of retrospective application of the new standard. We recommend that the IASB consults with users and preparers in this area and evaluates the costs and benefits of implementing this approach.

While we appreciate the time pressures on the IASB, ideally it would be preferable to consider all the proposals as a package once all the various phases of this project have been exposed for comment. In the absence of such an approach, we would recommend that the IASB considers the implications of the 'Classification and Measurement' phase on the 'Derecognition' phase, the other active phases on impairment and hedge accounting, as well as the IFRS 4 and financial statement presentation projects.

If you would like to discuss these comments, please contact Seema Jamil-O'Neill on 020 7492 2422 or myself on 020 7492 2434.

Yours sincerely

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Appendix: Response to the Invitation to Comment

Question 1
Does amortised cost provide decision-useful information for a financial asset or financial liability that has basic loan features and is managed on a contractual yield basis? If not, why?

1) We believe that amortised cost provides decision useful information for financial instruments where the cash flows represent principal and interest and the entity manages the instruments with a view to realising value from interest and principal repayments. Furthermore, it seems appropriate to measure those financial assets and financial liabilities that are not held for trading at amortised cost.

Question 2
Do you believe that the exposure draft proposes sufficient, operational guidance on the application of whether an instrument has 'basic loan features' and 'is managed on a contractual yield basis'? If not, why? What additional guidance would you propose and why?

2) The ASB has a number of comments on the sufficiency and practical application of the 'basic loan features' and 'managed on a contractual yield basis' concepts as described in the ED. These are discussed in detail below.

Primacy of the business model test

3) The ASB agrees that a financial asset or liability measured at amortised cost should meet the conditions set out in the ED. However, the ASB believes that some of the guidance proposed in this area needs improvement to ensure it represents a principle that can be applied consistently for classification, measurement and disclosure financial instruments across entities.

4) Paragraph 4 of the ED together with the detailed guidance in Appendix B (paragraphs B1-B13) gives the impression that the classification decision begins at the instrument level i.e. first an entity tests that it has basic loan features and only then determines whether the business manages it on a contractual yield basis.

5) Given the model proposed in the ED we believe it would be better (and closer to the actual likely application in practice) to give greater emphasis to the decisions being made at the business level so that subsequent to a transaction in financial instruments the entity would first determine the entity's business model (i.e. the rationale for undertaking the transaction) and then whether the instrument itself has basic loan features. Although making little difference to the classification and measurement at the financial instrument level, this has consequences on a wider financial statements level.

6) Consideration of the business model at the outset has the additional advantage of enabling the IASB to incorporate disclosure requirements that not only explain an entity's business strategy in relation the financial instruments on its financial statements but also ensures that any departure from or changes to it are clearly described in the financial statements. This would ensure that users have information on the classification as well as more focused and relevant information on its purpose within the entity's business. This would also ensure that changes in business direction are clearly articulated in the financial statements and disclosed in the accompanying notes.

The line between financial instruments at FV and at amortised cost

7) Whilst agreeing that reducing the financial instrument categories from four to two is an improvement the ASB is concerned about where the line is drawn between financial instruments that are at fair value and those at amortised cost. In particular, it appears that a high number of the instruments that are currently categorised as available-for-sale or held to maturity under IAS 39 may be categorised as being measured at fair value. This may be the right answer, however, there has been little IASB or public debate on whether that is the case. This issue is pertinent as the recent credit crisis highlighted problems with the fair value measurement model.

8) We understand that a number of entities, including insurance companies, will be impacted by this change. A number of insurance entities use the AFS category to ensure that the measurement of the assets they hold (mostly equities) is matched to that of the insurance liabilities the assets at supposed to offset. It is unclear if such assets would meet the criterion of investments in equity instruments that are not held for trading as described in paragraph 21 of the ED. We believe that it is desirable that the IASB conduct field tests encompassing a wide variety of entities which include, but are not limited to, banks.

Structuring Opportunities

9) Although in principle we understand the rationale for excluding all but the top tranches of structured entities from qualifying for amortised cost we are concerned about the rules-based nature of this requirement. The Basis for Conclusions (paragraph BC 28) makes clear that an entity is not required to look through the structure to ascertain whether the loan notes it invests in are based on leveraged investments. In our view, this make the requirements vulnerable to structuring opportunities. Examples of such structures could be repackaging of mid and lower tier notes of a structure into new SPVs which then issues notes which are considered the top tier and so included at amortised cost.

10) Other entities that are likely to be impacted by these requirements in the ED are private companies that are financed by structured debt. Some of these structures can be easily as complex as those for credit derivatives. It would be advisable that the IASB performs such field testing as time allows on a sample of these entities to confirm that consistent answers are achieved without causing undue cost for entities.

Treatment of Impaired loans

11) The ASB is not convinced that the measurement of acquired impaired loans and deep discounted bonds at fair value, as prescribed in the ED, is appropriate. Appendix B of the ED paragraph B13 states that financial assets acquired at a discount reflecting incurred credit losses are not managed on a contractual yield basis and hence cannot be categorised as being at amortised cost. BC29 goes on to explain that investors acquiring such instruments at a discount believe that the actual losses will be less than those reflected in the purchase price. It goes on to state that "that instrument creates exposure to significant variability in actual cash flows and such variability is not interest". We are not clear how this variability is any different to that in so called 'normal' loans. We are also concerned at the logic here which appears to link the classification of the instrument with the investor's (for financial reporting purposes the reporting entity's management's) intent rather than on what the business model is and whether it has basic loan features.

12) We do not agree with the assertions we have heard which state that 'normal' lending does not reflect expected credit losses. We believe there are examples of real life lending models such as sub-prime lending and certain high yield lending in the corporate arena where lenders are aware of expected credit losses by the new customer and so this is reflected in price of the loan i.e. the higher than average interest rates charged to the customer. However, all these loans are made with the view that in a portfolio of sub-prime or high yield loans a certain percentage, but not all, of the customers are likely to default on the loan. Hence the same variability in actual cash flows can be applied here.

13) We think that the IASB's discussions on the impairment model to be adopted for financial instruments are relevant here. Its current Request for Information on calculating impairment for financial assets at amortised cost proposes the use of an expected loss model. We think that model is implemented then there is no distinction between an "impaired" loan and a normal one as far as measurement is concerned – both require use of a probability weighted cashflow model.

Implications for financial liabilities

14) Certain structured liabilities issued by entities are deemed to contain an embedded derivative. Under the current requirements in IAS 39 the derivative is bifurcated and the liability is measured at amortised cost. However, under the proposals in the ED there will be no such bifurcation for structured liabilities and the entire instrument will be measured at fair value. The IASB's current ED 'Fair Value Measurement' would require that the measurement include the entity's own credit risk. The ASB is concerned that even entities that do not want to measure such instruments at fair value will be caught by this and would be placed in the position of having to explain to investors the impact of own credit risk on the valuation of own debt. Permitting separation of embedded derivatives will ensure that these valuation issues for financial liabilities do not arise. Failing that, the ASB would recommend that the IASB consider the

treatment of credit loss on such own debt once it has taken into account the responses to its discussion paper 'Credit Risk in Liability Measurement'[1].

15) Although the requirements of the ED are to impact both financial assets and financial liabilities equally we are concerned that most of the guidance is focussed on financial assets. So for example, the Basis for Conclusions sets out in paragraph BC29 that a financial asset acquired at a discount that reflects incurred credit losses is not considered to have basic loan features. However, there is no indication of whether the same is true for financial liabilities acquired. We would recommend that guidance to the final standard should be evenly balanced between financial assets and financial liabilities.

Basic loan features when Foreign Exchange is involved

16) The guidance included in Appendix B to the ED on basic loan features notes in paragraph B1 that "contractual terms that change the timing or amount of payments of principal or interest on the principal outstanding are not basic loan features unless they protect the creditor or debtor." What follows this are instances of when these requirements are met. However, we note there is no discussion of what impact transactions conducted in different currencies might have on this requirements. The only discussion on foreign exchange differences is contained in paragraph B25 which sets out the entity would apply IAS 21 to monetary items denominated in foreign currency and any resulting foreign exchange gains or losses will be recognised in the profit or loss.

17) However, what is not clear is whether an FX element contained within a financial instrument, which would otherwise have basic loan features, would still qualify to be classified as being at amortised cost. An example may be a GBP loan to a customer for which the interest is based on EURIBOR. An indication of whether this element of FX would render an otherwise basic loan to be valued at fair value is required. We note that this issue is also currently being considered in the context of rights issues in foreign currency where an ED of Amendments to IAS 32 was published by the IASB during August 2009.

Definitions

18) We note that the ED as currently drafted does not propose incorporating definitions of some new terms used in the proposed Standard. Instead most terms have been described in the application guidance contained in Appendix B. We would recommend that the a definitions section should incorporate definitions of key terms such as 'basic loan features' and 'managed on a contractual yield basis'

19) In our view, the guidance in paragraph B9 on the term 'managed on a contractual yield basis' needs to be better articulated. It currently states that:

[1] The ASB response to the DP was dated 28 July 2009. In it the ASB states that "it is important that different measurement methods are applied to different categories of liabilities so that objectives of financial reports are achieved. The ASB agrees that where fair value is an appropriate measurement method it will incorporate own credit risk – however it is important to first determine if fair value is the appropriate measure."

"Financial instruments are managed on a contractual yield basis only if they are managed, and their performance evaluated by the entity's key management personnel (as defined in IAS 24 Related Party Disclosures), on the basis of the contractual cash flows that are generated when held or issued (including any adjustment or consideration for prepayment provisions).

20) We believe that some combination of "managing for yield" and "managing to realise" (as much as is possible) the contractual cash flows is required. So a better description may be:

    'Financial instruments are managed on a contractual yield basis if they are managed for recovery of principle and interest rather than gains from changes in fair value'.

Question 3

Do you believe that other conditions would be more appropriate to identify which financial assets or financial liabilities should be measured at amortised cost? If so,

(a) what alternative conditions would you propose? Why are those conditions more appropriate?

(b) if additional financial assets or financial liabilities would be measured at amortised cost using those conditions, what are those additional financial assets or financial liabilities? Why does measurement at amortised cost result in information that is more decision-useful than measurement at fair value?

(c) if financial assets or financial liabilities that the exposure draft would measure at amortised cost do not meet your proposed conditions, do you think that those financial assets or financial liabilities should be measured at fair value? If not, what measurement attribute is appropriate and why?

21) Please see our response to question 2 in relation to structured transactions, treatment of impaired loans and impact on financial liabilities.

22) In relation to the treatment of impaired loans and financial liabilities we believe that carrying these at amortised cost would ensure consistency of application of the overall principle of classification. As a result, the financial information provided to users will be less complex and easier to understand, making it more decision-useful.

Question 4

(a) Do you agree that the embedded derivative requirements for a hybrid contract with a financial host should be eliminated? If not, please describe any alternative proposal and explain how it simplifies the accounting requirements and how it would improve the decision-usefulness of information about hybrid contracts.

(b) Do you agree with the proposed application of the proposed classification approach to contractually subordinated interests (i.e. tranches)? If not, what approach would you propose for such contractually subordinated interests? How is that approach consistent with the proposed classification approach? How would that approach simplify the accounting requirements and improve the decision-usefulness of information about contractually subordinated interests?

Elimination of embedded derivative requirements for financial host contacts:

23) The ASB does not agree with the elimination of the requirement to bifurcate embedded derivatives from a financial host contract at this point. We agree with the IASB that the embedded derivative requirements for a hybrid contract with a financial host are complex and its elimination will simplify the existing guidance in this area. However, we are also aware of the downsides arising from the removal of these requirements. We have identified one in relation to own debt in the answer to question 2.

24) Another significant drawback is that the proposals will lead to more reliance on the legal structure of transactions. So a debt instrument with a conversion option embedded will be reported at fair value but an identical debt instrument where the conversion option is written as a separate contract will be reported at amortised cost and the option at fair value. We think this inconsistency of accounting treatment for financial instruments with identical economic effect but different legal structures is undesirable.

25) We believe that another practical implication of this approach is likely to be that it could result in more hybrid contracts with financial hosts being measured at fair value.

Application to structured transactions

26) We understand the rationale for the requirement in paragraph B8 that "any tranche that provides credit protection to other tranches in any situation does not have basic loan features. The tranches are not principal and interest because its holder is compensated for providing that credit protection." However, we see a number of problems in application of the requirements as currently drafted.

27) Firstly, it is a simplification of the structuring process to state that the tranches only consist of principal, interest and credit risk/enhancement elements. This ignores the correlation risk that is inherent in all structuring transactions based on large underlying pools of assets. Another aspect is to do with inbuilt liquidation triggers. A large number of the SPVs that failed during this credit crisis did so as a result of their bankruptcy remote nature and the rules, specified at the outset of the transactions, around the proportionate levels of assets and

liabilities to be held by the issuing SPV which stipulated its immediate dissolution once the trigger ratio was reached.

28) Secondly, it is also a simplification to state that (as in paragraph B27) only the most senior tranche will receive credit protection in any situation. Fair values of senior tranches of a number of structures issued by European banks were written down nearer the 20 cents in the $ mark during the recent credit crisis when it was shown that default rate were far higher than those assumed at initial valuation and the perceived credit protection provided by the lower tranches far lower than that assumed on initial valuation. We do not believe that there should be differences in how different tranches of a structure are classified. However, if the IASB were to retain a differentiation between classification of the various tranches of a structure it may be helpful to incorporate a double test as follows – if you can look through the securitisation in one stage, and if the tranche is a net credit receiver, it should qualify for amortised cost accounting.

29) Further, it is not clear to us whether the issuer and the investor of the structure's notes will be applying the same classification. In BC28 it is stated that the IASB decided against looking through to the underlying assets of a structured investment vehicle as it would not work for debtors other than structured investment vehicles with a narrow scope. However, this logic can easily be stretched to state that although the issuer will account for the top tranche at amortised cost and the remaining at fair value, as the investor is not looking through the structure it can account for all such loan notes at amortised cost. We believe that by limiting the accounting to the legal structures the results are even more counterintuitive than the issue as outlined by the IASB.

30) As a result, we believe that in the form currently proposed in the ED the application of the proposed classification approach to contractually subordinated interests will not achieve the desired outcome. Transactions will be structured so that tranches below the top will not provide credit protection so as to qualify for amortised cost classification.

31) The perceived anomaly can be overcome by requiring entities to account for the substance of the transaction as a whole rather than focusing on the legal structure. In the case of a trade debtor the substance is that of basic loan features. But for the vast majority of structured transactions the substance of the transaction would be significantly different to what the legal structures first imply. We believe that accounting for individual tranches does not automatically lead to the transaction as a whole being captured in the financial statements. If this was the case, why would the entity incur the cost and effort of creating the structure? Significantly, as most of these transactions are over the counter both the issuer and investor have sufficient information to account for these transactions in accordance with the economic substance.

Application to non-financial host contacts

32) Accounting for embedded derivatives is an area for complexity for both financial and non-financial host contracts. Therefore, we would encourage the IASB to revisit the requirements for embedded derivatives in non-financial host contract

in the near future and ensure the treatment for the two is consistent as far as is possible.

33) Paragraph 7 refers to hosts which are "not within the scope of this [draft] IFRS". It would be better to use the terminology non-financial host and financial host in paragraphs 7 and 8 respectively so that there is no ambiguity around when separation is required.

34) Paragraph 8 states that "An entity shall apply the requirements in paragraphs 3-5 to all other hybrid contracts". We believe that application guidance is required to demonstrate that it would be possible for the entire hybrid contract to be held at either amortised cost or fair value

Question 5
Do you agree that entities should continue to be permitted to designate any financial asset or financial liability at fair value through profit or loss if such designation eliminates or significantly reduces an accounting mismatch?

35) We agree that the fair value option should be retained where such a designation eliminates or significantly reduces an accounting mismatch.

Question 6
Should the fair value option be allowed under any other circumstances? If so, under what other circumstances should it be allowed and why?

36) In respect of the proposals currently in the ED we do not think the fair value option should be allowed under any other circumstances.

37) We would however like to highlight that there are significant links between the ability and ease with which entities are able to achieve hedge accounting treatment and their propensity to use the fair value option to report economic hedges. As a result, we believe the IASB would need to revisit these requirements once it has decided on the hedge accounting requirements.

Question 7
Do you agree that reclassification should be prohibited? If not, in what circumstances do you believe reclassification is appropriate and why do such reclassifications provide understandable and useful information to users of financial statements? How would you account for such reclassifications, and why?

38) No. The ASB believes that reclassification should be permitted. Either the prohibition on reclassification in the ED would result in some financial instruments being classified inappropriately in the event of changes in business models (rare but not unlikely) or such prohibitions would lead to structuring of transactions to achieve the desired outcome. We believe that these outcomes will not enhance comparability between entities, which is the stated aim for this prohibition. In fact, it is very likely that this prohibition will manifest itself in

two entities with similar business models reporting very different measurements for identical financial instruments which they manage in an identical manner just because one changes its business model and hence the way it uses the financial instrument.

39) We agree with the principle that entities should not be able to reclassify on an ad hoc basis. As noted in our answer to question 2 above we believe that reclassification would be appropriate in the event of a change in an entity's business model to reflect this change and its impact on how the entity manages a particular financial instrument or a group of financial instruments. Some of our constituents are of the view that in the event of change in the business model reclassifications should be made mandatory to ensure there is consistency across entities with the same business models.

40) Reclassifications should be accounted for prospectively. Full disclosures, giving the reasons for the change and the financial impact had the change not been made, would be provided.

Question 8

Do you believe that more decision-useful information about investments in equity instruments (and derivatives on those equity instruments) results if all such investments are measured at fair value? If not, why?

41) We believe that measuring all equity investments at fair value simplifies the existing requirements and eliminates the need for impairment testing. This approach involves eliminating the current cost exemption available for measurement of unquoted equity investments. There are likely to be costs involved for preparers and difficulties in obtaining reliable valuations for such instruments. Nonetheless we consider that a single measurement approach for all equity instruments is preferable.

Question 9

Are there circumstances in which the benefits of improved decision-usefulness do not outweigh the costs of providing this information? What are those circumstances and why? In such circumstances, what impairment test would you require and why?

42) For non-financial institutions holding a few unquoted equity investments for strategic purposes the benefits of improved decision-usefulness do not outweigh the costs of providing this information. The costs associated with obtaining a reliable valuation for such equity instruments are likely to be considerable outweighing the benefits. However, some guidance in the IASB's upcoming Fair Value Measurement standard on how to establish fair value in a cost effective manner in these circumstances may help alleviate preparers' concerns. Furthermore, disclosures on the assumptions and mechanics of the valuation model will enable users understand the level of judgement in the calculation.

Question 10
Do you believe that presenting fair value changes (and dividends) for particular investments in equity instruments in other comprehensive income would improve financial reporting? If not, why?

43) We believe that presenting fair value changes for equity instruments that are strategic in nature in other comprehensive income would improve financial reporting. Volatility in the profit and loss account would be reduced. In this way the profit and loss account would only reflect gains and losses arising from trading activities. This approach is consistent with the accounting for gains and losses on revaluation of PPE.

44) We support the view that there should be no recycling of items recorded in OCI through the profit and loss account.

45) One further area we believe that needs consideration concerns disclosures. If a business model overlay is assumed then we believe that the above accounting treatment would need to be accompanied by disclosures that present the information in such a way as to clarify how this classification fits in with the business model of the entity.

46) However, we believe that the answer to this question is interlinked with the 'Financial Statements Presentation' project. It is important that before such changes are made that some consideration is given to an overall principle that would determine the split between those items for which performance is reported in the 'profit or loss' account and those for which it is reported in 'other comprehensive income'. We believe resolving this question will enable the IASB to address this issue across the board rather than just in the context of this specific exemption.

Question 11
Do you agree that an entity should be permitted to present in other comprehensive income changes in the fair value (and dividends) of any investment in equity instruments (other than those that are held for trading), only if it elects to do so at initial recognition? If not,

(a) how do you propose to identify those investments for which presentation in other comprehensive income is appropriate? Why?

(b) should entities present changes in fair value in other comprehensive income only in the periods in which the investments in equity instruments meet the proposed identification principle in (a)? Why?

47) We agree that the option to present non-trading equity instruments in OCI should be available only at initial recognition as an entity is likely to have

acquired an equity instrument with the intention of holding it for a specific purpose.

48) We believe that permitting entities to recognise equity instruments in OCI at any time this may result in 'cherry picking', whereby an entity may selectively choose to present fair value gains arising from these instruments in profit and loss and if the instrument becomes loss making an entity may decide that the investment is now held for strategic purposes and therefore 'hide' losses in OCI.

Question 12
Do you agree with the additional disclosure requirements proposed for entities that apply the proposed IFRS before its mandated effective date? If not, what would you propose instead and why?

49) We agree with the additional disclosure requirements proposed for entities that apply the proposed IFRS before its mandated effective date. It may be helpful to clarify upfront that the proposed changes refer to the classification and measurement phase only and all other requirements of IAS 39 remain unchanged.

50) The ASB also notes that Appendix C paragraph 44H of the ED proposes disclosure requirements applicable to entities that choose to apply the new standard on classification and measurement of financial instruments prior to the effective date. These include disclosures for each class of financial instruments: of the original measurement category and carrying amount under IAS 39; the new measurement category and carrying amounts; the amount of financial instruments reclassified under the fair value option; and the amount of financial instruments measured at fair value under IAS 39 but are no longer so designated. The ASB believes that such transitional disclosures are important for users of all financial statements whether the entity elects to early adopt the requirements or not. Accordingly, we would recommend that these disclosures are extended to all entities upon transition to the new standard.

Question 13
Do you agree with applying the proposals retrospectively and the related proposed transition guidance? If not, why? What transition guidance would you propose instead and why?

51) We have reservations about retrospective application on the basis of the practical difficulties this would cause preparers. We understand that IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' requires that where there is a change in accounting policy arising from a new IASB standard, the change in accounting policy is applied retrospectively unless it is impracticable to do so. However, we aware that preparers, in particular banks and insurance companies, are citing significant practical difficulties in implementation of the new standard. These difficulties are related to cost and time required to implement significant systems changes to enable holding companies to collate the information as well as staff training needs. We recommend that the IASB considers further these

practical implications before continuing to press ahead with retrospective application.

52) One further issue relates to the level of change the insurance industry is likely to be subjected to in the next few years. We are aware the insurance phase II accounting standard is likely to be applicable in or soon after 2012 and the requirements of Solvency II are also likely to become effective in 2012. As a result the effective date of this new standard on classification and measurement is likely to have a significant impact for the insurance industry both in terms of time available to deal with practical implementation issues as well as the interaction between the insurance standard and classification and measurement of financial instruments. We would recommend the IASB consider these issues carefully before finalising this standard.

Question 14

Do you believe that this alternative approach provides more decision-useful information than measuring those financial assets at amortised cost, specifically:

(a) in the statement of financial position?

(b) in the statement of comprehensive income?

If so, why?

53) We do not agree with the alternative approach as it adds a level of complexity to reporting financial assets at amortised cost which is unnecessary.

(a) We understand that under the alternative approach all financial assets would be at fair value in the statement of financial position other than those that meet the current definition of loans and receivables; and have basic loan features and are managed on a contractual yield basis. This effectively restricts the number of financial instruments that will be at amortised cost in the statement of financial position, leading to more financial instruments being measured at fair value. We do not believe this would necessarily lead to decision-useful information given the shortcomings of fair value measurement highlighted by the credit crisis.

(b) We do not agree that split reporting in the statement of financial information provides decision useful information. It is likely to reduce volatility associated with changes in the profit and loss account but at the same time is unlikely to provide an accurate representation of the cash flows associated with the financial instrument. The number in OCI would be a ‘plug’ arising from the difference between fair value and amortised cost of the financial instrument which would be a meaningless figure when viewed in isolation. Preparers would need to maintain a two sets of accounting records, one on each basis which would be cumbersome. In practice, most preparers present an income statement and statement of OCI on separate pages which breaks the link between the two performance statements.

Question 15
Do you believe that either of the possible variants of the alternative approach provides more decision-useful information than the alternative approach and the approach proposed in the exposure draft? If so, which variant and why?

54) We believe that the first variant of the alternative approach which requires fair value changes to be disaggregated within profit or loss would provide little benefit compared to the costs involved for preparers.

55) The second variant, where all financial instruments would be held in the statement of financial position at fair value, would be less complex than the alternative approach in the ED and is likely to bring the IASB model closer to that of the FASB. However, as already stated above the ASB believes that the mixed measurement model provides decision useful information. Additionally, under this variant the complexity associated with disaggregation in other comprehensive income would remain.