

Regulation Impact Statement
AASB 7
Financial Instruments: Disclosures

Background

The Australian Accounting Standards Board (AASB) is implementing the Financial Reporting Council's (FRC) strategic directives 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 the requirements applicable to general purpose financial reports of public sector entities and those applicable to Government Finance Statistics. To put the first of the FRC directives into effect the AASB is issuing Australian equivalents to IASB Standards and has undertaken a separate project in respect of harmonising financial reporting requirements and Government Finance Statistics. Implementation of the FRC's Year 2005 strategic directive 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 sector-neutral Standards, that is, Standards applicable to both for-profit and 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 possible, as the basis for International Public Sector Accounting Standard (IPSAS). 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 The AASB also retains guidance from superseded AASB Standards in an Appendix to the new Standards where it considers that guidance to be important to facilitate implementation and compliance with a Standard. In addition, in respect of optional treatments included in IASB Standards, the AASB decided it would generally require only one treatment in order to facilitate comparability of financial reports in Australia.

AASB 7 *Financial Instruments: Disclosures* is part of the set of Australian equivalents to IASB Standards, and is the Australian equivalent of the IASB's IFRS 7 *Financial Instruments: Disclosures*.

1. Problem

Accounting Standards AASB 130 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions* and AASB 132 *Financial Instruments: Disclosure and Presentation* replicate the international standards IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions* and IAS 32 *Financial Instruments: Disclosure and Presentation*. The IASB concluded that there was a need to revise and enhance the disclosures in IAS 30 and IAS 32. As part of that revision, in August 2005 the IASB issued IFRS 7 *Financial Instruments: Disclosures* to supersede IAS 30 and the disclosure requirements of IAS 32. Retention of AASB 130 and AASB 132 by the AASB would be inconsistent with the FRC's directive on IASB Standards. This is because the requirements in IFRS 7 differ from those in AASB 130 and AASB 132 and the application of IFRS 7 is wider than AASB 130 and AASB 132, which provide relief for parent entities from making certain disclosures when the parent's financial statements are presented with the group financial statements and the group complies with all of the disclosures.

2. Objectives

The AASB's objectives in addressing the problem are to improve the quality and usefulness of financial reporting in Australia in respect of both for-profit and not-for-profit reporting entities in the private and public sectors and to implement the FRC's directives.

3. Options

Option 1

Adopt IFRS 7.

Option 2

Not adopt IFRS 7 and retain AASB 130 and AASB 132.

Option 3

Adopt IFRS 7 and include relief for parent entities in respect of some disclosures.

Option 1 enables compliance with the FRC directive. Option 2 would mean that there would not be an Australian Standard equivalent to IFRS 7 and this would be inconsistent with the FRC's policy directive relating to adoption of IASB Standards. Option 3 enables compliance with the FRC directive in respect of group financial statements while minimising the extent of detailed disclosure requirements for parent entities.

4. Impact Analysis

When issuing Exposure Drafts of Australian equivalents of 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. 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 reports. 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 strategic directive as a whole.

Under section 227(1) of the *Australian Securities and Investments Commission Act 2001* (ASIC Act), the functions of the AASB are 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.

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 1 January 2005; and
- harmonise the requirements applicable to general purpose financial reports of public sector entities and those applicable to Government Finance Statistics.

Adopting IFRS 7 will have an impact on current Australian practice. IFRS 7 applies to all risks arising from all financial instruments, except those covered by another more specific standard such as interests in subsidiaries, associates and joint venture, post-employment benefits, share-based payment and insurance contracts. Although IFRS 7 applies to all entities, the extent of disclosure required depends on the extent of the entity's use of financial instruments and of its exposure to risk.

IFRS 7 requires disclosure of:

- the significance of financial instruments for an entity's financial position and performance. These disclosures incorporate many of the requirements previously in AASB 132; and
- qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk. The

qualitative disclosures describe management's objectives, policies and processes for managing those risks. The quantitative disclosures provide information about the extent to which the entity is exposed to risk, based on information provided internally to the entity's key management personnel. Together, these disclosures provide an overview of the entity's use of financial instruments and the exposures to risks they create.

IFRS 7 applies to both parent and group financial statements. AASB 130 and AASB 132 provide that a range of detailed disclosures need not be presented in the parent's financial statements if those statements are presented with group financial statements that are prepared in accordance with the Standard.

5. Consultation

The AASB issued Exposure Draft ED 137 Request for Comment on IASB ED 7 *Financial Instruments: Disclosures* in August 2004, the Australian equivalent to the IASB ED 7 *Financial Instruments: Disclosures*. ED 137 proposed the replication of the parent entity relief currently available in AASB 130 and AASB 132 (a proposal not contemplated by ED 7). Seven submissions were received in respect of the proposals in the ED and there was substantial support for adopting an Australian equivalent to IFRS 7. Five constituents agreed that AASB 7 should replicate the parent entity relief in AASB 130 and AASB 132. One constituent commented that the AASB should adopt a more proactive approach to persuade the IASB to replicate the parent entity relief in AASB 130 and AASB 132. The other constituent argued that the use of the parent entity relief represents a departure from the 'convergence' principle that would result in non-compliance with AASB 101 *Presentation of Financial Statements* and incompatibility with the respective equivalent IFRS.

6. Conclusion and Recommendation

In complying with the FRC directive in relation to IASB Standards the AASB decided to follow Option 1 and adopt IFRS 7 by making an Australian equivalent to IFRS 7 and issuing it as AASB 7 *Financial Instruments: Disclosures*. The AASB decided not to permit parent entity relief in AASB 7. The AASB noted the historical reasons for providing relief, but also noted the absence of any fundamental principle for providing relief.

The AASB decided to delete paragraph B6 from AASB 7, because the AASB's legal authority does not extend beyond setting accounting standards for application to the financial statements and associated notes (and therefore, does not extend to the type of report contemplated in paragraph B6 of IFRS 7).

In forming this conclusion, the AASB considered that, on balance, the benefits of facilitating the Australian economy by reducing the cost of capital, enabling entities to compete effectively overseas and the provision of information that is relevant, reliable and facilitates comparability outweighed the costs to individual entities of adopting Australian equivalents to IASB Standards.

7 Implementation and Review

AASB 7 will be subject to review and revision taking account of international developments, particularly the processes for review and revision undertaken by the IASB, and of the experience of constituents in implementing the Standard.