28 January 2022

Dr Andreas Barckow
Chair
International Accounting Standards Board
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Via online submission: www.ifrs.org

Dear Dr Barckow

Request for Information – Post-implementation Review: IFRS 9 *Financial Instruments* - Classification and Measurement

As the representatives of over 300,000 professional accountants in Australia, New Zealand and around the world, CPA Australia and Chartered Accountants Australia and New Zealand (CA ANZ) thank you for the opportunity to comment on the above Request for Information (the RFI).

Our stakeholder outreach activities undertaken as part of developing this submission indicate that IFRS 9's classification and measurement requirements are, in most instances, providing useful information as intended. The following aspects of the classification and measurement requirements have operated as intended in most instances:

- the business model for managing financial assets,
- the contractual cash flow characteristics assessment, and
- modifications to contractual cash flows.

Based on feedback we have received, we understand that preparers occasionally encounter problems because the guidance is not complete on some of the key principles and requirements. In order to improve consistent application of the requirements, we recommend that the Board develop comprehensive application guidance underpinned by principles and requirements. We also encourage the development of more application guidance to assist emerging business sectors and developing trends, for example, the emergence of cryptoassets and related liabilities.

In subsequent post-implementation reviews of IFRS 9 that will consider impairment and hedge accounting, we recommend that the IASB take a more holistic approach that incorporates not only the other parts of IFRS 9 but also other IFRSs that deal with the disclosure (IFRS 7 *Financial Instruments: Disclosures*) and presentation requirements (IAS 32 *Financial Instruments: Presentation*) of financial instruments. Similarly, other projects such as the current consultation on non-current liabilities with covenants may also have an impact on the various parts of IFRS 9, including the classification and measurement requirements that are the topic of this RFI.

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More detail on these issues is included in our responses to the detailed questions posed in the RFI in the **Attachment** to this letter.

If you have any questions about our submission, please contact either Ram Subramanian (CPA Australia) at ram.subramanian@cpaaustralia.com.au or Amir Ghandar (CA ANZ) at amir.ghandar@charteredaccountantsanz.com.

Yours sincerely

Dr Gary Pflugrath FCPA
Executive General Manager,
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Attachment

Question 1 Classification and measurement **Do the classification and measurement requirements in IFRS 9:** **(a) enable an entity to align the measurement of financial assets with the cash flow characteristics of the assets and how the entity expects to manage them? Why or why not?** **(b) result in an entity providing useful information to the users of the financial statements about the amount, timing and uncertainty of future cash flows? Why or why not?**

(a) Yes, our outreach and research indicates the classification and measurement requirements in IFRS 9 enable alignment of the measurement of financial assets with their cash flow characteristics and the manner in which they are managed. We have not identified significant issues relating to the classification and measurement requirements.

(b) Yes, in most instances, the classification and measurement requirements in IFRS 9 provide a logical basis for preparers to provide useful information to the users of financial statements. Some specific exceptions are discussed in our responses to Questions 2 and 3.

Question 2 Business model for managing financial assets **(a) Is the business model assessment working as the Board intended? Why or why not?** **(b) Can the business model assessment be applied consistently? Why or why not?** **(c) Are there any unexpected effects arising from the business model assessment? How significant are these effects?**

(a) We are of the view that, in most cases, the business model assessment operates as intended. However, based on feedback we have received, we understand that the application guidance relating to the assessment of the business model (specifically paragraphs B4.1.3, B4.1.3A and B4.1.3B) under which financial assets are held to collect contractual cash flows needs improvement to provide more clarity. For example, current application guidance indicates that sales of financial assets for credit risk and credit concentration management reasons do not change the business model for managing assets. However, there is little application guidance to assist in identifying circumstances when the business model does change. Examples (paragraph B4.1.4) based on fact patterns to illustrate an outcome are useful for entities with matching circumstances but they may not lead to consistent application for preparers with comparable but marginally different circumstances. As part of the proposed improvement to application guidance, we recommend the inclusion of key indicators, where appropriate, to highlight which indicators are the primary considerations to support the principles-based guidance.

We have received feedback that IFRS 9 requires more judgement than its predecessor standard IAS 39 *Financial Instruments: Recognition and Measurement*. We accept this

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approach as being an outcome attributed to principles-based standards and will continue to support the principles-based approach to the IFRS 9 classification and measurement requirements.

There is, however, a need for the development of practical application guidance to assist in the consistent exercise of professional judgement in applying the principles-based classification and measurement requirements.

(b) Yes, we believe the assessment may be applied consistently in most circumstances, except as stated in our above response to Question 2(a).

(c) No, we are not aware of any significant impacts or unexpected effects from the assessment.

Question 3 Contractual cash flow characteristics

(a) Is the cash flow characteristics assessment working as the Board intended? Why or why not?

(b) Can the cash flow characteristics assessment be applied consistently? Why or why not?

(c) Are there any unexpected effects arising from the cash flow characteristics assessment? How significant are these effects?

(a) Yes, we are of the view that the cash flow characteristics assessment is appropriate for conventional market-based financial assets, e.g., market-traded bonds and fixed-term deposits.

(b) No, we believe there are some financial instruments that, in addition to the normal characteristics associated with financial lending arrangements, have some non-financial incentives-based or specific industry arrangements which could pose challenges for consistent application of the assessment. These financial instruments can be characterised by terms and conditions which are not solely payments of principal or interest, for example:

- Interest-free loans to related parties for liquidity management purposes,
- Variable rate loans based on environmental, social and governance (ESG) targets achieved by the borrowers (also identified in the RFI), and
- Islamic banks' financial assets which include profit-sharing components.

Based on the above examples, it is unclear whether the interest income includes other considerations unrelated to basic lending risks.

We are of the view that there is a need for additional guidance (paragraphs B4.1.7, B4.1.7A and B4.1.7B) to address specific arrangements including those identified above. We strongly recommend more principles-based guidance to clarify what constitutes 'principal' and 'interest' for the assessment and whether non-financial characteristics could form part of these elements. Consistent accounting treatment is important because financial assets with ESG performance components, interest-free loans to related parties and Islamic banking financial assets are becoming more common. Having consistent accounting treatments prompts comparability and provides more useful information.

(c) Except for the concerns stated in our above response to Question 3(b), we are not aware of any other unexpected effects.

Question 4 Equity instruments and other comprehensive income

(a) Is the option to present fair value changes on investments in equity instruments in OCI working as the Board intended? Why or why not?

(b) For what equity instruments do entities elect to present fair value changes in OCI?

(c) Are there any unexpected effects arising from the option to present fair value changes on investments in equity instruments in OCI? How significant are these effects?

(a) We understand that the Board's decision was made to accommodate limited circumstances whereby the fair value movements are not representative of the entity's performance. Based on our outreach activities, we note that the fair value changes on investments in equity instruments presented in Other Comprehensive Income (OCI) are quite common. A common reason for applying fair value changes in OCI is to manage the volatility in the operating results. We are not aware of significant concerns regarding this practice.

However, we support further standard-setting work on the presentation of fair value changes on investments in equity instruments in OCI. Recent research has found that investor groups and regulators find that the OCI is relevant to understanding an entity's financial performance. At present, this is not well understood and therefore the information included in OCI, including movements arising from financial instruments, is not given a great deal of focus.

(b) Please refer to our response to Question 4(a).

(c) Our outreach indicates that there are no significant concerns about presenting fair value changes in OCI, including the prohibition from recycling of gains and losses on investments in equity instruments through profit or loss. Generally, there is limited understanding why some OCI items are recycled to profit or loss and other items are not. We are concerned that this lack of understanding may reduce the usefulness of the financial statements particularly during economic downturns or periods of financial stress.

Question 5 – Financial liabilities and own credit

(a) Are the requirements for presenting the effects of own credit in OCI working as the Board intended? Why or why not?

(b) Are there any other matters relating to financial liabilities that you think the Board should consider as part of this post-implementation review (apart from modifications, which are discussed in Section 6)?

(a) Yes, we agree that this presentation leads to an appropriate outcome. Please refer to our comments about OCI in our response to Question 4.

(b) No.

Question 6 – Modifications to contractual cash flows

(a) Are the requirements for modifications to contractual cash flows working as the Board intended? Why or why not?

(b) Can the requirements for modifications to contractual cash flows be applied consistently? Why or why not?

(a) Yes, generally the requirements for modifications to contractual cash flows are clear, well-understood and working as intended.

(b) The requirements may be applied consistently in most instances. However, some preparers have also requested additional guidance regarding modifications to contractual cash flows to ensure consistency is achieved. There is some judgement involved in determining when a modified asset should be recognised as a new asset. We are of the view that additional application guidance would support such judgement and clarify which criteria need to be considered and prioritised by those applying the standard. We believe this approach will support a more consistent and justifiable decision that appropriately reflects the underlying economic circumstances.

Question 7 – Amortised cost and the effective interest method

(a) Is the effective interest method working as the Board intended? Why or why not?

(b) Can the effective interest method be applied consistently? Why or why not?

(a) Yes, for most entities, the effective interest method works as intended. However, please refer to our response to Question 3 where we have raised some concerns about measurement for some financial instruments.

(b) Yes, the method can be applied consistently for financial assets.

Question 8 – Transition

(a) Did the transition requirements work as the Board intended? Why or why not?

(b) Were there any unexpected effects of, or challenges with, applying the transition requirements? Why or why not?

(a) We have not received any feedback that indicates the transition requirements did not work as intended.

(b) No.

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Question 9 – Other matters

(a) Are there any further matters that you think the Board should examine as part of the post-implementation review of the classification and measurement requirements in IFRS 9? If yes, what are those matters and why should they be examined?

(b) Considering the Board's approach to developing IFRS 9 in general, do you have any views on lessons learned that could provide helpful input to the Board's future standard-setting projects?

(a) We strongly urge the Board to update IFRS 9 with more balanced, complete and specific application guidance to assist preparers where significant judgement is required.

(b) While we commend the Board's post-implementation review initiatives, we would also encourage future projects to examine related sections of the standard with a more holistic perspective. For example, we do not believe that it is best practice to conduct a review of IFRS 9 encompassing measurement without examining impairment and hedge accounting simultaneously. We encourage the Board to revisit recognition and measurement when a post-implementation review is carried out for impairment and hedge accounting. In addition, we also believe there are benefits in leveraging other concurrent open consultations, such as non-current liabilities with covenants and supplier finance arrangements, to gather feedback which may also inform this post-implementation review.

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