19 July 2023

Dr Andreas Barckow
Chair
International Accounting Standards Board
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Via online submission: www.ifrs.org

Dear Andreas

Exposure Draft: Amendments to the Classification and Measurement of Financial Instruments (Proposed amendments to IFRS 9 and IFRS 7)

Chartered Accountants Australia and New Zealand (CA ANZ) and CPA Australia represent over 300,000 professional accountants who work in diverse roles across public practice, commerce, industry, government and academia throughout Australia, New Zealand and internationally. We welcome the opportunity to provide feedback on the Exposure Draft (the ED) and commend the IASB's efforts to address feedback identified through the Post-implementation Review: IFRS 9 *Financial Instruments* – Classification and Measurement. We make this submission on behalf of our members and in the public interest.

Our main observations and recommendations are set out below.

- We support the proposal to introduce an option to derecognise a financial liability settled with cash using an electronic payment system when the payment instruction is initiated. However, we recommend that the term 'electronic payment system' is defined.
- We support further clarification on how to assess whether cash flows are consistent with a basic lending arrangement for the purpose of applying the solely payments of principal and interest (SPPI) test, particularly for financial assets with ESG-linked features. However, we recommend additional clarification around when financial assets with ESG-linked features are consistent with a basic lending arrangement and therefore meet the SPPI test, and that the proposed requirement in paragraph B4.1.10A for the occurrence (or non-occurrence) of a contingent event to be 'specific to the debtor' is considered further.
- Whilst we support enhancements to clarify the meaning of a "non-recourse" financial asset, we believe further interpretative challenges may arise as a result of the inclusion of paragraphs B4.1.16A and B4.1.17A. We suggest revisiting these paragraphs to further clarify the meaning of non-recourse financial assets.
- We support clarifying the distinction between contractually linked instruments and non-recourse financial assets. However, we recommend it is explicitly stated that contractually linked instruments only need to be assessed using the criteria in paragraphs B4.1.20–B4.1.26.

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- We recommend that the IASB reconsiders the scope of the disclosures, includes disclosure objectives, further explores the cost-benefit of providing such disclosures, and removes any duplicative disclosures.
- We agree with the proposed transitional provisions, including there being no requirement to restate comparatives. However, we encourage the IASB to consider individual transition requirements to allow for the separate adoption of certain amendments earlier than others.

Our responses to the specific questions raised in the ED are included in the **Attachment** to this letter. Should you have any questions about the matters raised in this submission or wish to discuss them further, please contact either Amir Ghandar (CA ANZ) at amir.ghandar@charteredaccountantsanz.com or Ram Subramanian (CPA Australia) at ram.subramanian@cpaaustralia.com.au.

Yours sincerely

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Attachment

Question 1 Derecognition of a financial liability settled through electronic transfer

Paragraph B3.3.8 of the draft amendments to IFRS 9 proposes that, when specified criteria are met, an entity would be permitted to derecognise a financial liability that is settled using an electronic payment system although cash has yet to be delivered by the entity.

Paragraphs BC5–BC38 of the Basis for Conclusions explain the IASB's rationale for this proposal.

Do you agree with this proposal? If you disagree, please explain what aspect of the proposal you disagree with. What would you suggest instead and why?

We support the proposal to introduce an option to derecognise a financial liability settled with cash using an electronic payment system, when the payment instruction is initiated. It addresses the issue that a paying entity does not necessarily know when the receiving entity receives the payment. However, to address potential unintended consequences of the proposals as currently drafted, we suggest further clarifications.

We recommend that the term 'electronic payment system' is defined. It is not clear whether the scope of the proposals only include the transfer of money from one bank account to another, or whether it also includes other methods of settling liabilities electronically, for example card-based payments, including debit cards and credit cards. We suggest this is clarified.

We recommend that paragraph B3.3.8 is clarified by reconsidering the criteria in (a)-(c), to provide a more practical and cost-effective method of managing and recording transactions. We highlight a few matters below in this regard:

- It has the potential to create an accounting mismatch. Once the payment instruction is initiated there is a presumption that the corresponding financial asset (cash) will be derecognised. The proposals do not specifically address the corresponding derecognition of the financial asset under the option in paragraph B3.3.8. For example, is there a need to recognise cash-in-transit for the brief period between the payment instruction and the point at which cancellation is no longer possible.
- The difference between having the "ability" in criterion B3.3.8(a) and the "practical ability" in criterion B3.3.8(b) is not clear. This may also require a legal opinion which would be costly and time-consuming.
- In practice it is unlikely that an entity would meet criterion B3.3.8(a) (no ability to withdraw, stop or cancel the payment instruction)
- It is not clear why criterion B3.3.8(b) and criterion B3.3.8(c) (the settlement risk associated with the electronic payment system is insignificant) are separate criteria. We are not aware of any examples where an entity could pass one test but fail the other.

We note that the ED does not address the concerns raised by respondents (including those noted in paragraph BC8(a-b)) to the IFRIC tentative agenda decision *Recognition of Cash Received via an Electronic Transfer as Settlement for a Financial Asset* (TAD). We do not believe that there needs to be symmetry between the receiving entity's recognition of cash (and derecognition of the trade receivable) and the paying entity's derecognition of cash (and derecognition of the trade payable) (as noted in paragraph BC18). Whilst we acknowledge the rationale provided in the Basis for Conclusions as to why the IASB decided to only allow settlement date accounting for derecognition of financial assets, we do not believe the concerns raised by respondents to the TAD have been adequately addressed.

Question 2—Classification of financial assets—contractual terms that are consistent with a basic lending arrangement

Paragraphs B4.1.8A and B4.1.10A of the draft amendments to IFRS 9 propose how an entity would be required to assess:

(a) interest for the purposes of applying paragraph B4.1.7A; and

(b) contractual terms that change the timing or amount of contractual cash flows for the purposes of applying paragraph B4.1.10.

The draft amendments to paragraphs B4.1.13 and B4.1.14 of IFRS 9 propose additional examples of financial assets that have, or do not have, contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.

Paragraphs BC39–BC72 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

We support further clarification around how to assess whether cash flows are consistent with a basic lending arrangement for the purpose of applying the solely payments of principal and interest (SPPI) test, particularly for financial assets with ESG-linked features. However, we are concerned that these proposed amendments would further increase the complexity of IFRS 9, and potential unintended consequences for existing financial assets that currently meet the SPPI test. In our view there is a risk that the proposed amendments would need to be reviewed again as new instruments emerge in the future. In our joint submission to the IASB's RFI PIR of IFRS 9 Classification and Measurement, we recommended more principles-based guidance to address financial instruments such as those with ESG-linked features. However, in light of our above comments, it may be more advantageous for the IASB to conduct a first principles review of the SPPI test in IFRS 9, instead of ad hoc amendments.

We recommend additional clarification around when financial assets with ESG-linked features are consistent with a basic lending arrangement and therefore meet the SPPI test. Whilst we support further clarification by way of illustrative examples, the proposed additional examples are basic, and examples that consider more complex scenarios would be well received. Furthermore, in the example underneath paragraph B4.1.13 the analysis column arrives directly at the conclusion without any discussion around how Instrument EA meets each of the criteria in paragraphs B4.1.7A–B4.1.10A. It is important that the rationale is clearly articulated so the principles can be applied to other financial assets.

We recommend that the proposed requirement for the occurrence (or non-occurrence) of a contingent event to be 'specific to the debtor' in paragraph B4.1.10A is considered further. It is not clear how this assessment should be applied to contingent events that are dependent partially on the debtor and partially on external factors, and contingent events that are specific to the group that the debtor is part of, but not the debtor itself.

Question 3—Classification of financial assets—financial assets with non-recourse features

The draft amendments to paragraph B4.1.16 of IFRS 9 and the proposed addition of paragraph B4.1.16A enhance the description of the term 'non-recourse'.

Paragraph B4.1.17A of the draft amendments to IFRS 9 provides examples of the factors that an entity may need to consider when assessing the contractual cash flow characteristics of financial assets with non-recourse features.

Paragraphs BC73–BC79 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

We support enhancements to clarify the meaning of a "non-recourse" financial asset. However, we are concerned that the description of financial assets with non-recourse features provided in paragraphs B4.1.16A and B4.1.17A of the ED could give rise to additional interpretative challenges that could be inconsistent with the current interpretation assigned to "non-recourse" in current practice. For example, paragraph B4.1.17A suggests that an entity may need to consider the legal and capital structure of the debtor, including the cash flows generated by the underlying asset. In practice, this information may not be available to the entity.

We recommend that the IASB clarifies whether it was the intention to narrow the amount of financial assets that are considered to have non-recourse features to waterfall arrangements. Extant paragraph B4.1.16 refers to a "non-recourse" financial asset being when a creditor's claim is limited to specified assets of the debtor (i.e., in the case of default) *or* the cash flows from specified assets (i.e., over the life of the financial asset). Whereas proposed paragraph B4.1.16A states that a financial asset with non-recourse features has limited cash flows both over the life of the financial asset *and* in the case of default.

Question 4—Classification of financial assets—contractually linked instruments

The draft amendments to paragraphs B4.1.20–B4.1.21 of IFRS 9, and the proposed addition of paragraph B4.1.20A, clarify the description of transactions containing multiple contractually linked instruments that are in the scope of paragraphs B4.1.21– B4.1.26 of IFRS 9.

The draft amendments to paragraph B4.1.23 clarify that the reference to instruments in the underlying pool can include financial instruments that are not within the scope of the classification requirements of IFRS 9.

Paragraphs BC80–BC93 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

We support clarifying the distinction between contractually linked instruments and non-recourse financial assets. However, we are concerned that this gives rise to potential further confusion that both

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the non-recourse and contractually linked instrument contractual cashflow tests may apply to contractually linked instruments, as one is a subset of the other. We recommend it is explicitly stated that contractually linked instruments only need to be assessed using the criteria in paragraphs B4.1.20–B4.1.26. This is currently only implicit in paragraph B4.1.20A.

Question 5—Disclosures—investments in equity instruments designated at fair value through other comprehensive income

For investments in equity instruments for which subsequent changes in fair value are presented in other comprehensive income, the Exposure Draft proposes amendments to:

(a) paragraph 11A(c) of IFRS 7 to require disclosure of an aggregate fair value of equity instruments rather than the fair value of each instrument at the end of the reporting period; and

(b) paragraph 11A(f) of IFRS 7 to require an entity to disclose the changes in fair value presented in other comprehensive income during the period.

Paragraphs BC94–BC97 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

We recommend that the IASB reconsiders the scope of the disclosures, includes disclosure objectives, further explores the cost-benefit of providing such disclosures, and removes any duplicative disclosures.

Subject to the above, we agree with the proposed disclosures for investments in equity instruments designated at fair value through other comprehensive income. We understand that the information needed for the proposed disclosure requirements is readily available so should not add a significant amount of cost for most preparers. We believe that this will go some way in bridging the gap in users' understanding of changes in fair value of equity instruments presented in other comprehensive income, including investments that have been derecognised, and increase the usefulness of the financial statements.

Question 6—Disclosures—contractual terms that could change the timing or amount of contractual cash flows

Paragraph 20B of the draft amendments to IFRS 7 proposes disclosure requirements for contractual terms that could change the timing or amount of contractual cash flows on the occurrence (or non-occurrence) of a contingent event. The proposed requirements would apply to each class of financial asset measured at amortised cost or fair value through other comprehensive income and each class of financial liability measured at amortised cost (paragraph 20C).

Paragraphs BC98–BC104 of the Basis for Conclusions explain the IASB's rationale for this proposal.

Do you agree with this proposal? Why or why not? If you disagree, please explain what aspect of the proposal you disagree with. What would you suggest instead and why?

As noted in our response to Question 5, we recommend inclusion of the objective of the proposed disclosures. As currently drafted, there are no disclosure objectives that describe and explain users' information needs which is inconsistent with the IASB's *Guidance for developing and drafting disclosure requirements in IFRS Accounting Standards*. Therefore, it is not clear how the proposed disclosures would be useful for investor decision-making.

We do not agree with the proposed disclosures for contractual terms that could change the timing or amount of contractual cash flows. We are concerned about the broad scope which increases the risk of:

(i) boilerplate disclosures that are potentially irrelevant and obscure more useful information, and
(ii) litigation in relation to forward looking information which is subjective in nature.

We recommend that the IASB reconsiders the scope of the disclosures to improve the usefulness for users of financial statements.

We also recommend that the IASB further explores the cost-benefit of providing such disclosures. To collect the necessary information for the proposed disclosures, entities may have to update their systems and processes. As a result, producing the proposed disclosure requirements could be time consuming and costly for preparers to implement.

We recommend removal of any duplicative disclosure requirements, which in turn would also reduce the risk of inconsistencies with existing disclosure requirements. For example, paragraph B10A of IFRS 7 already requires similar disclosures for liabilities to assist users in assessing liquidity risk, and *Non-current Liabilities with Covenants* which amended IAS 1 *Presentation of Financial Statements* to require disclosure of information related to covenants.

Question 7—Transition

Paragraphs 7.2.47–7.2.49 of the draft amendments to IFRS 9 would require an entity to apply the amendments retrospectively, but not to restate comparative information. The amendments also propose that an entity be required to disclose information about financial assets that changed measurement category as a result of applying these amendments.

Paragraphs BC105–BC107 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

We agree with the proposed transitional provisions, including there being no requirement to restate prior periods caused by the application of the proposed amendments. However, we encourage the IASB to consider individual transition requirements to allow for the separate adoption of certain amendments earlier than others, for example, the requirements that relate to financial assets with ESG-linked features.