Australian Government

Australian Accounting Standards Board

Postal Address

PO Box 204

Collins Street West VIC 8007

Telephone: (03) 9617 7600

Dr. Andreas Barckow
Chairman
International Accounting Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf, London E14 4HD
UNITED KINGDOM

(submitted via the IASB website)

17 July 2023

Dear Dr. Barckow,

IASB Exposure Draft ED/2023/2 *Amendments to the Classification and Measurement of Financial Instruments – Proposed amendments to IFRS 9 and IFRS 7*

The Australian Accounting Standards Board (AASB) is pleased to have the opportunity to provide comments on the International Accounting Standards Board (IASB) Exposure Draft (ED/2023/2) *Amendments to the Classification and Measurement of Financial Instruments,* proposing amendments to IFRS 9 *Financial Instruments* and IFRS 7 *Financial Instruments: Disclosures* issued in March 2023.

In formulating these comments, the views of Australian stakeholders were sought and considered. This consultation included the following outreach activities to gather views from stakeholders:

(a) AASB Financial Instruments Project Advisory Panel;

(b) AASB User Advisory Committee;

(c) other targeted consultations with preparers, auditors and professional bodies.

The AASB acknowledges the efforts of the IASB to respond to feedback on the post-implementation review of the classification and measurement requirements in IFRS 9. However, we noted that the proposals, as currently drafted, could have consequences beyond the objective of the proposals explained in the Basis for Conclusions. As discussed in detail in the Appendix to this letter, we highlight the following matters:

(a) We suggest further consideration of the proposed paragraph B3.1.2A about settlement date accounting and clarification of the amendments relating to the derecognition of financial liabilities settled through electronic transfer (Question 1).

(b) We recommend further clarification of the proposed amendments relating to the assessment of contractual cashflow characteristics for loans with contingent features (Question 2).

(c) We suggest that the IASB undertakes a cost-benefit analysis of the proposed disclosures for loans with contingent features (Question 6).

If you have any questions regarding this letter, please do not hesitate to contact me or Deputy Technical Director, Fridrich Housa (fhousa@aasb.gov.au).

Yours sincerely,

Dr. Keith Kendall

Chair – AASB

APPENDIX

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 specific 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?

The AASB is concerned that the proposed paragraph B3.1.2A and aspects of the drafting of paragraphs B3.3.8 and B3.3.9 could have consequences beyond clarifying current practice and should be further considered or clarified. Specific comments and suggestions are as follows:

1. The proposed paragraph B3.1.2A states that when recognising or derecognising a financial asset or financial liability, an entity shall apply settlement date accounting (except for regular way purchases and sales). Reducing the recognition and derecognition requirements in IFRS 9 (Chapter 3) to settlement date accounting could have consequences beyond clarifying current requirements. For example, some stakeholders noted there are exceptions to settlement date accounting in IFRS 9 and B3.1.2A might cause confusion.

2. The proposed paragraph B3.3.8 would permit entities to discharge financial liabilities settled with cash using an electronic payment system (e.g. trade payables) before the settlement date if certain conditions are met. We note that some stakeholders thought the nature of the corresponding credit entry was unclear due to the overarching requirement to apply settlement date accounting for financial assets in paragraph B3.1.2A (as drafted).

3. Paragraphs B3.3.8(a)-(c) and B3.3.9 set out the proposed requirements an entity must meet if they wish to deem that a financial liability settled with cash using an electronic payment system is discharged before the settlement date. While it is not immediately apparent that this would have significant implications for Australian entities, we suggest the drafting should be clarified. For example:

   (a) Paragraph B3.3.8(a) requires that after a payment is initiated, an entity should have "no ability" to withdraw, stop or cancel the payment, while paragraph B3.3.8(b) says the entity should have "no practical ability" to access the cash. Some stakeholders thought the requirement in B3.3.8(a) might be difficult to ascertain for Australian entities. Further, it is not clear why paragraph B3.3.8(a) appears to be an absolute requirement (with possible legal implications) while B3.3.8(b) refers to practical ability. We suggest that if the proposed drafting is amended, B3.3.8(a) may not be required. Alternatively, B3.3.8(a) could be changed to refer to a practical ability if the term was defined.

   (b) Paragraph B3.3.8(c) would require an insignificant settlement risk associated with the electronic payment system. B3.3.9 clarifies this requirement stating that the period between initiating a payment instruction and the cash being delivered must be short. There should be a clear definition of what the word 'short' means.

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?

The drafting of paragraphs B4.1.8A and B4.1.10A is unclear and does not sufficiently clarify the principles of the classification assessment. Specific comments and suggestions are as follows:

1. The proposed paragraph B4.1.8A explains that some payment types are inconsistent with the definition of a basic lending arrangement. The wording of this paragraph could be clarified as suggested below:
    (a) Paragraph B4.1.8A states that in assessing whether the contractual cash flows of a financial asset are consistent with a basic lending arrangement, an entity may have to consider the different elements of interest separately. It would be helpful to add the IASB's wording from the Basis for Conclusions (BC47) that the elements of interest specified in paragraph B4.1.7A (i.e. consideration for the time value of money, credit risk, liquidity risk, costs and profit margin) are not an exhaustive list.
    (b) Further, paragraph B4.1.8A states, "... a change in contractual cash flows is inconsistent with a basic lending arrangement if it is not aligned with the direction and magnitude of the change in basic lending risks or costs." The wording in the Basis for Conclusions (BC52), which explains that a change in contractual cash flows must be directionally consistent with and proportionate to a change in lending risks or costs, is clearer than the double negative employed in B4.1.8A and avoids the need to clarify the new term 'magnitude.'
2. The proposed paragraph B4.1.10A requires that to be consistent with a basic lending arrangement, the occurrence of a contingent event must be specific to the debtor. We request clarification of the following matters:
    (a) When evaluating the terms that change the timing or amount of contractual cashflows, paragraph B4.1.10 requires the entity to determine whether the contractual cashflows that could arise over the life of the instrument are solely payments of principal and interest (SPPI). In doing so, the entity may evaluate the nature of possible contingent events. For the purpose of this evaluation, whether or not the contingent event is specific to the debtor is treated as indicative rather than determinative. The requirement in B4.1.10A appears more restrictive than B4.1.10. We request confirmation that this is an intended change or clarification of the matter if it is not a change.

(b) If the requirement that a contingent event must be specific to the debtor is intended to be determinative (as noted above), further guidance may be needed in some circumstances, for example to illustrate how the requirement might apply in a group context. As currently drafted, it is unclear how to apply the guidance in situations when the loan is provided to one legal entity (perhaps a holding company or financing entity) but the ESG-related metrics are determined with reference to all companies in the group or to an operating subsidiary's emissions.

3. Our stakeholders asked for more complex examples than those in B4.1.13 and B4.1.14. However, clarification of the principles of the classification assessment should mitigate the need for additional illustrative examples.

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?

The drafting of paragraph B4.1.16 may have consequences beyond the clarification of existing practice and should be further considered. Specific comments are as follows:

1. The existing paragraph B4.1.16 refers to non-recourse features where a *creditor's claim* is limited to specified assets of the debtor or the cash flows from specified assets. However, this would be replaced by paragraph B4.1.16A, which states, "A financial asset has non-recourse features if an entity's contractual right to receive cash flows is limited to the cash flows generated by specified assets *both* over the life of the financial assets *and* in the case of a default" [emphasis added]. Although we do not expect this clarification will significantly change existing practice, the proposed 'both/and' requirement might (in some cases) be more restrictive than current requirements.

2. We note that according to the Basis for Conclusions (paragraph BC74) stakeholders asked the IASB to clarify the difference between financial assets with non-recourse features and financial assets for which the creditor's claim is secured by assets pledged as collateral. The explanation in paragraph BC75 more clearly answers this question and may be less restrictive than the wording in paragraph B4.1.16A.[1]

1 Paragraph BC75 explains that non-recourse features refer to the absence of a liability on the part of the debtor beyond any underlying assets pledged as collateral. This is in contrast to a collateralised loan, where the creditor's claim is secured by the collateral only in the case of default. Therefore, throughout the life of a collateralised loan, the creditor has recourse only to the debtor for repayment.

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?

The AASB supports the IASB's intention to clarify the assessment of the contractual cash flow characteristics of financial assets that are contractually linked instruments. However, some stakeholders noted that the wording of the proposed paragraph B4.1.20A is quite specific and could have consequences beyond clarification of the existing practice (e.g. implications for structuring transactions). We ask the IASB to reconsider the drafting.

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

The AASB welcomes the proposed enhancements to the disclosure requirements for investments in equity instruments designated at fair value through other comprehensive income. However, the lists of individual disclosure requirements in paragraphs 11A and 11B together with illustration of the requirements in paragraphs IG11A and IG11B may be confusing. We suggest that the reconciliation provided as an illustrative example in the Implementation Guidance would provide a better framework for the disclosures and the information would be more useful to users. Alternatively, some stakeholders requested that the IASB cross reference the line items in the illustrative example to the applicable sub-sections in paragraphs 11A and 11B to improve clarity.

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?

The AASB agrees that users may find information about the effect of contractual terms that could change the timing or amount of contractual cash flows useful. However, we suggest the IASB clarifies the objective of the suggested disclosures (e.g. existence of the contingent event and its effect on the pricing) and assesses the cost of the proposed disclosures relative to the expected benefit to financial statements users. Specific feedback from our stakeholders is below:

1. Preparers thought entities might have difficulty capturing the quantitative information in paragraphs 20B(b) and (c) as it could be located in different systems across a business. This could make the disclosure very costly. They also noted that the disclosure would apply to all loans with contingent features, not just those with ESG-linked features.
2. Concerns were also expressed around commercial sensitivity if entities disclose the extent of their involvement with loans that have ESG features and their pricing (even at an aggregated level), as required by paragraphs 20B(b) and (c).
3. It was also suggested that the existing requirements in IFRS 7 (paragraphs 31-42) may already meet this need or could be amended to provide useful information with less cost to preparers. For example, the Implementation Guidance (B10A) already requires entities to disclose when cash outflows could be of different timing or amount.
4. Users thought the proposed disclosure would be useful; however, they offered little feedback on how the disclosures might be used. Specifically, they discussed that the disclosure provides information about the possible range of changes to contractual cashflows, which is difficult to relate to interest income and expense.

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? Deadline

The AASB requests the IASB to clarify whether the transition requirements could be implemented individually or must be implemented at the same time.