Contact: Sean Osborn
Telephone: (02) 9228 5932

Dr Keith Kendall
Chair
Australian Accounting Standards Board
PO Box 204
Collins Street West
VIC 8007 Australia

Dear Dr Kendall

ITC 47 *Request for Comment on IASB Request for Information on Post-Implementation Review of IFRS 9 Financial Instruments – Classification and Measurement*

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to respond to ITC 47 *Request for Comment on IASB Request for Information on Post-Implementation Review of IFRS 9 Financial Instruments – Classification and Measurement*. HoTARAC is an intergovernmental committee that advises Australian Heads of Treasuries on accounting and reporting issues. The Committee comprises senior accounting policy representatives from all Australian states and territories and the Australian Government.

HoTARAC supports the principles-based approach to classification and measurement in IFRS 9 and the simplification of measurement categories. For the majority of public sector preparers of financial statements, the classification and measurement requirements introduced in IFRS 9 had little effect on their accounting for financial instruments.

HoTARAC believes that further guidance would be helpful on:

- distinguishing between modifications and the de-recognition of financial assets
- initial measurement of concessional loans
- measurement of concessional financial guarantees
- subsequent measurement of statutory receivables
- trade date versus settlement date accounting for financial liabilities

If you have any queries regarding HoTARAC's comments, please contact Sean Osborn from New South Wales Treasury on (02) 9228 5932 or by email to sean.osborn@treasury.nsw.gov.au.

Yours sincerely

Stewart Walters

CHAIR
Heads of Treasuries Accounting and Reporting Advisory Committee
24 December 2021

ENCLOSED:

HoTARAC Comments to the AASB on ITC 47 *Request for Comment on IASB Request for Information on Post-Implementation Review of IFRS 9 Financial Instruments – Classification and Measurement*

HoTARAC Comments to the AASB on ITC 47 *Request for Comment on IASB Request for Information on Post-Implementation Review of IFRS 9 Financial Instruments – Classification and Measurement*

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?

Please provide information about the effects of the classification and measurement changes introduced by IFRS 9, including the ongoing costs and benefits in preparing, auditing, enforcing or using information about financial instruments.

This question aims to help the Board understand respondents' overall views and experiences relating to the IFRS 9 classification and measurement requirements. Sections 2–8 seek more detailed information on the specific requirements.

For the majority of public sector preparers of financial statements, the classification and measurement requirements introduced in IFRS 9 had little effect on their accounting for financial instruments.

In general, IFRS 9 provides a more principles-based approach to classification and measurement of financial instruments, compared to the previous AASB 139 *Financial Instruments: Recognition and Measurement*. Financial instruments measurement categories have been reduced to fair value through profit/loss (FVPL), fair value through other comprehensive income (FVOCI) and amortised cost.

The rationalisation of measurement categories helped reduce complexity and these changes were supported by HOTARAC. HOTARAC agrees that the classification and measurement of financial assets should be based on the nature of the assets expected cash flows (Solely Payments of Principal and Interest (SPPI)) criteria and the entities business model for managing those cash flows. For example, financial assets can only be measured at amortised cost where expected cash receipts are SPPI, with all other financial assets required to be measured at fair value.

AASB 9 classification and measurement requirements are also consistent with the Government Finance Statistic (GFS) harmonisation requirements of AASB 1049 *Whole of Government and General Government Sector Financial Reporting* (AASB 1049). AASB 1049 requires compliance with the GFS Manual where consistent with Australian Accounting Standards (AASB 1049(13)), including the measurement of financial assets and liabilities at fair value where possible (AASB 1049(14b)) and separate presentation in the operating statement of revenues and expenses from transactions and from other economic flows (OEF) (AASB 1049(30)). HOTARAC notes that amortised cost measurements would usually continue to approximate fair value, unless market interest rates significantly change since initial recognition of the loan. AASB 9(4.1.5) also allows entities to elect, on initial recognition, to measure financial assets at FVPL where it eliminates or significantly reduces a measurement or recognition inconsistency.

Question 2—Business model for managing financial assets

a) Is the business model assessment working as the Board intended? Why or why not?

   Please explain whether requiring entities to classify and measure financial assets based on the business model assessment achieves the Board's objective of entities providing users of financial statements with useful information about how an entity manages its financial assets to generate cash flows.

b) Can the business model assessment be applied consistently? Why or why not?

c) Please explain whether the distinction between the different business models in IFRS 9 is clear and whether the application guidance on the evidence an entity considers in determining the business model is sufficient. If diversity in practice exists, please explain how pervasive the diversity is and its effect on entities' financial statements.

d) Are there any unexpected effects arising from the business model assessment? How significant are these effects?

   Please explain the costs and benefits of the business model assessment, considering any financial reporting or operational effects for preparers of financial statements, users of financial statements, auditors or regulators.

In responding to (a)–(c), please include information about reclassification of financial assets (see Spotlight 2).

HOTARAC agrees that reporting entities' business models are relevant for distinguishing between financial assets held at FVPL and FVOCI, because it distinguishes financial assets held for trading from financial assets held for collection of cash flows. Examples of financial assets held at FVOCI include General Government Sector (GGS) investments in Government Business Enterprises (GBEs) and International Monetary Fund (IMF) quotas. HOTARAC notes that AASB 1049 already requires separate presentation of transactions and other economic flows in public sector consolidated income statements.

The guidance outlined in AASB 9 sections B4.1.1 to B4.1.6 is considered sufficient for assessing entities' business models for managing financial assets and the criteria can be consistently applied. HOTARAC expects that the reclassification of financial assets due to a change in business model is uncommon in Australian governments' financial reports.

Question 3—Contractual cash flow characteristics

a) Is the cash flow characteristics assessment working as the Board intended? Why or why not?
Please explain whether requiring entities to classify and measure a financial asset considering the asset's cash flow characteristics achieves the Board's objective of entities providing users of financial statements with useful information about the amount, timing and uncertainty of future cash flows.

If, in your view, useful information could be provided about a financial asset with cash flows that are not SPPI applying IFRS 9 (that is, an asset that is required to be measured at fair value through profit or loss applying IFRS 9) by applying a different measurement approach (that is, using amortised cost or fair value through OCI) please explain:
   i. why the asset is required to be measured at fair value through profit or loss (that is, why, applying IFRS 9, the entity concludes that the asset has cash flows that are not SPPI).
   ii. which measurement approach you think could provide useful information about the asset and why, including an explanation of how that approach would apply. For example, please explain how you would apply the amortised cost measurement requirements to the asset (in particular, if cash flows are subject to variability other than credit risk). (See Section 7 for more questions about applying the effective interest method.)

b) Can the cash flow characteristics assessment be applied consistently? Why or why not?
Please explain whether the requirements are clear and comprehensive enough to enable the assessment to be applied in a consistent manner to all financial assets within the scope of IFRS 9 (including financial assets with new product features such as sustainability-linked features). If diversity in practice exists, please explain how pervasive the diversity is and its effect on entities' financial statements.

c) Are there any unexpected effects arising from the cash flow characteristics assessment? How significant are these effects?
Please explain the costs and benefits of the contractual cash flow assessment, considering any financial reporting effects or operational effects for preparers of financial statements, users of financial statements, auditors or regulators.

In responding to (a)–(c), please include information about financial instruments with sustainability-linked features (see Spotlight 3.1) and contractually linked instruments (see Spotlight 3.2).

HOTARAC agrees that the cash flow characteristics of financial assets are relevant for distinguishing between financial assets held at FVPL and those held at amortised cost or FVOCI. HOTARAC believes that financial assets which do not meet the SPPI criteria should not be measured at amortised cost. The guidance outlined in section B4.1.7 to B4.1.26 is considered sufficient for assessing whether the SPPI cash flow criteria are met and the SPPI criteria can be consistently applied.

Some Australian government concessional loan schemes, such as Higher Education Loan Program (HELP) loans, have income contingent repayment arrangements through the tax system. These loan schemes are treated as failing the SPPI test and are measured at FVPL.

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?

   Please explain whether the information about investments in equity instruments prepared applying IFRS 9 is useful to users of financial statements (considering both (i) equity instruments measured at fair value through profit and loss; and (ii) equity instruments to which the OCI presentation option has been applied).

   For equity instruments to which the OCI presentation option has been applied, please explain whether information about those investments is useful considering the types of investments for which the Board intended the option to apply, the prohibition from recycling gains and losses on disposal and the disclosures required by IFRS 7.

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

   Please explain the characteristics of these equity instruments, an entity's reason for choosing to use the option for those instruments, and what proportion of the entity's equity investment portfolio comprises those instruments.

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?

   Please explain whether the requirements introduced by IFRS 9 had any effects on entities' investment decisions. If yes, why, how and to what extent? Please provide any available evidence supporting your response which will enable the Board to understand the context and significance of the effects.

In responding to (a)–(c), please include information about recycling of gains and losses (see Spotlight 4).

HOTARAC believes that the FVOCI option for investments in equity instruments is appropriate. Some Australian Government equity investments (including some investments in private funds and corporations and all investments in public corporations held at GGS level) are measured at FVOCI.

In the GGS financial statements, the interest in the PNFC and PFC sectors is accounted for in accordance with AASB 1049. The election to account for the change in the carrying amount of these investments in a manner consistent with the treatment of equity instruments measured at FVOCI in AASB 9, that would otherwise be measured at FVTPL, is generally taken in Australia. Movements in the carrying amount are taken through 'Other Economic

Flows - Other Comprehensive Income'. These gains and losses on these investments are never reclassified to the 'Operating Result'.

These investments are generally held on an ongoing basis for policy reasons rather than for trading and investment returns and hence fair value gains and losses are appropriately recorded directly in equity. HOTARAC is not aware of any unintended effects from the FVOCI measurement option for equity investments.

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?

   Please explain whether the requirements, including the related disclosure requirements, achieved the Board's objective, in particular, whether the requirements capture the appropriate population of financial liabilities.

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)?

   Please explain the matter and why it relates to the assessments the Board makes in a post-implementation review.

Because government borrowings are generally risk free or near risk free, the issue of accounting for fair value changes in liabilities due to changes in own credit risk is not significant for Australian government general government sector (GGS) entities. HOTARAC notes that where applicable, separating out the change in fair value in liabilities due to changes in own credit risk may be difficult and would increase accounting complexity.

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?

Please explain what changes you consider to be modifications of a financial asset for the purpose of applying paragraph 5.4.3 of IFRS 9 and as a modification of a financial liability for the purpose of applying paragraph 3.3.2 of IFRS 9. Does the application of those paragraphs, and the disclosure requirements related to modifications, result in useful information for users of financial statements?

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

Please explain whether the requirements enable entities to assess in a consistent manner whether a financial asset or a financial liability is modified and whether a modification results in derecognition. Have the requirements been applied differently to financial assets and financial liabilities?

If diversity in practice exists, please explain how pervasive the diversity is and its effects on entities' financial statements.

AASB 9 does not contain any explicit guidance on determining whether a modification to the contractual cash flows of a financial asset results in derecognition. In the absence of explicit guidance for the derecognition of a financial asset arising from a modification, most users assume an analogy should be made to the guidance for the modification of financial liabilities.

HoTARAC believes that further guidance distinguishing between modifications and the de-recognition of financial instruments, particularly for financial assets and including the accounting in each case, may be helpful.

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) Please explain whether applying the requirements results in useful information for users of financial statements about the amount, timing and uncertainty of future cash flows of the financial instruments that are measured applying the effective interest method.

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

   Please explain the types of changes in contractual cash flows for which entities apply paragraph B5.4.5 of IFRS 9 or paragraph B5.4.6 of IFRS 9 (the 'catch-up adjustment') and whether there is diversity in practice in determining when those paragraphs apply.

   Please also explain the line item in profit or loss in which the catch-up adjustments are presented and how significant these adjustments typically are.

   If diversity in practice exists, please explain how pervasive the diversity is and its effect on entities' financial statements.

In responding to questions (a)–(b), please include information about interest rates subject to conditions and estimating future cash flows (see Spotlight 7).

HOTARAC believes that amortised cost measurements are a practical measurement model that would usually continue to approximate fair value after initial recognition. However, where market interest rates significantly change after initial recognition, potential divergences in amortised cost and fair value measurements for loans may occur.

HOTARAC also notes that initial recognition of financial assets held at amortised cost, at their fair value results in a duplication of the expected credit loss allowance (ECLA) This issue is known to the IASB and is referenced in AASB 9 para BC5.198. However, it remains an issue and HoTARAC recommends that the IASB address it.

Paragraph B5.4.5 of AASB 9 appears unclear. Further guidance on whether amortised cost measurement can be applied to variable interest rate financial instruments may be helpful.

Question 8—Transition

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

Please explain whether the combination of the relief from restating comparative information and the requirement for transition disclosures achieved an appropriate balance between reducing costs for preparers of financial statements and providing useful information to users of financial statements.

Please also explain whether, and for what requirements, the Board could have provided additional transition reliefs without significantly reducing the usefulness of information for users of financial statements.

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

Please explain any unexpected effects or challenges preparers of financial statements faced applying the classification and measurement requirements retrospectively. How were those challenges overcome?

HoTARAC believes the transitional provisions of AASB 9 were effective in reducing financial statement preparation costs whilst still providing useful financial information to users.

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?

Please explain why those matters should be considered in the context of the purpose of the post-implementation review, and the pervasiveness of any matter raised. Please provide examples and supporting evidence when relevant.

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?

Differences of views about the relationship between paragraphs B5.1.1 and B5.1.2A, regarding initial measurement of concessional loans.

The fair value of a concessional loan is different from the transaction price. Paragraph B5.1.1 requires that the difference in value created by a loan with off-market interest be recorded as an expense. Paragraph B5.1.2A addresses instruments on initial recognition where the transaction price is different from the fair value, and for instruments that do not have quoted prices in active markets requires initial deferral of any difference rather than immediate recording as an expense. There is no known diversity in practice, with B5.1.1 given primacy. However, we have heard views that B5.1.2A should be applied.

This inconsistency can be addressed relatively easily within IFRS 9. The issue is also referenced in paragraph 31(b)(iii) of AASB 1049 *Whole of Government and General Government Sector Financial Reporting*.

Practical issues with measurement of concessional financial guarantees.

These are guarantees where the government chooses to support an entity which may not be in a position to pay fees for a guarantee from a private sector provider. The guarantee may be provided at rates which are substantially lower than a private sector provider would charge. Such guarantees are relatively common in government and there has been diversity of views about how to measure the liability for such guarantees and whether to classify related revenues and expenses as transactions or other economic flows. Issues include:

- Inability to readily measure fair value, given the lack of market information for such guarantees. Market information is significantly less available than for other types of concessional financial instruments, leading to diversity of views and potential unreliable information being reported.
- Calculating fair value on initial measurement for concessional guarantees where an annual fee is received. There has been a diversity of views about the value that should be recorded, such as incorporation of “own credit risk”.
- Additional guidance in AASB 9 about fair value would resolve or mitigate these issues.
- Further, AASB 1049 *Whole of Government and General Government Sector Financial Reporting* would be improved with inclusion of the treatment of concessional financial guarantees in paragraph 31.

Subsequent measurement of statutory receivables

Australian amendments (Aus2.1.1) were made to AASB 9 to apply the principles of IFRS 9 to initial measurement of statutory receivables such as taxes and rates, even though such receivables are not contractual and hence not financial instruments. The AASB chose not to make consequent amendments to subsequent measurement, resulting in an inconsistency between initial and subsequent measurement. HoTARAC notes that initial measurement under AASB 9 added considerably to the workload of initial recognition of such receivables and is not convinced that the benefits outweighed the costs. HoTARAC members have not undertaken a more detailed formal analysis of the issue, but appear to express different views about whether application of AASB 9 should be extended to subsequent measurement, or whether the amendments to AASB 9 should be reversed.

Measurement and classification issues that arise from classification and hedging issues:

- Do the GFS requirements for fair value movements in derivatives (i.e as other economic flows in operating result) preclude the use of hedge accounting? This would seem to be inappropriate if all other conditions for applying hedge accounting are met. This also has consequences for the presentation of the operating statement.
- We acknowledge that these issues might also be considered in future phases of the IASB post implementation review project. However, they do have consequences for measurement.

Trade date versus settlement date accounting for financial liabilities

IFRS 9 does not contain any specific requirements about trade date and settlement date accounting for financial liabilities. IFRS 9.IG.B.32 discusses the recognition and derecognition of financial liabilities. It states "IFRS 9 does not contain any specific requirements about trade date accounting and settlement date accounting in the case of transactions in financial instruments that are classified as financial liabilities. The general recognition and derecognition requirements in paragraphs 3.1.1 and 3.3.1 of IFRS 9 apply. Paragraph 3.1.1 of IFRS 9 states that financial liabilities are recognised on the date the entity 'becomes a party to the contractual provisions of the instrument'. **Such contracts generally are not recognised unless one of the parties has performed**." (emphasis added)."

Further guidance would be helpful to understand

- Why IFRS 9 is silent on this issue for financial liabilities, when it has specific rules for financial assets?
- In relation to IFRS 9 IG.B.32, does the date that the entity becomes party to the contractual provisions of the instrument coincide with the date on which one of the parties has performed? Was the intention of the standard that financial liabilities are not recognised until one of the parties has performed? In relation to borrowings, HoTARAC's view is that neither counterparty has performed until settlement date i.e. when the lender has transferred funds to the borrower.
- Given IFRS 9 prescribes different rules for the recognition of financial assets and financial liabilities, does the standard anticipate that financial assets and financial liabilities can be recognised by the two parties at different points in time?
- If trade date accounting is required for financial liabilities, further guidance would be helpful to determine the interest calculation under the amortised cost method when interest only accrues from settlement date.