Australian Government

Australian Accounting Standards Board

Staff Paper

Project:	**IFRS 9 Classification and Measurement**	**Meeting:**	June 2023 (M196)
Topic:	**Stakeholder feedback, staff analysis and recommendations**	**Agenda Item:**	11.0
		Date:	22 June 2023
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		Decision-Making:	High
		Project Status:	Comment letter drafting

Objective of this agenda item

1 The objective of this agenda item:

(a) To inform the Board about the International Accounting Standards Board Exposure Draft/2023/2 *Amendments to the Classification and Measurement of Financial Instruments: Proposed amendments to IFRS 9 and IFRS 7*.

(b) For the Board to consider the staff analysis of stakeholders' feedback and matters for inclusion in the comment letter.

Background

2 In September 2021, the International Accounting Standards Board (IASB) published a Request for Information (RFI) *Post-implementation Review of IFRS 9 - Classification and Measurement*. The due date for comments was 28 January 2022.

3 In October 2021, the AASB issued an Australian equivalent Invitation to Comment (ITC 47). The ITC 47 comment period was closed on 31 December 2021.

4 In January 2022, the AASB submitted its comments on the RFI to the IASB.

5 In March 2023, the IASB published the Exposure Draft/2023/2 *Amendments to the Classification and Measurement of Financial Instruments: Proposed amendments to IFRS 9 and IFRS 7* (ED/2023/2). The due date for comments is 19 July 2023.[1]

6 At its March 2023 meeting, the Board agreed to make a submission to the IASB on ED/2023/2.

[1] The IASB has also published a 'Snapshot' for ED/2023/2 that provides an overview of the proposals.

7 In March 2023, the AASB issued an Australian equivalent [Exposure Draft ED 324](). The ED 324 comment period was closed on 31 May 2023.

Outreach activities

8 Staff have received no written submissions on ED324. Staff conducted the following outreach activities to gather views from stakeholders:

(a) 24 May 2023 – AASB FIPAP meeting. Eight FIPAP members provided feedback to AASB staff on the exposure draft;

(b) 9 June 2023 – AASB staff attended a joint meeting arranged by CAANZ and CPA Australia to obtain the views of their members. Five practitioners provided feedback on the exposure drafts;

(c) 13 June 2023 – AASB User Advisory Committee (UAC) meeting. Three UAC members provided feedback to AASB staff on the exposure draft;

(d) other targeted consultations. One audit firm provided feedback to AASB staff.

Feedback from Australian stakeholders, staff analysis and recommendations

9 ED/2023/2 proposes amendments to IFRS 9 *Financial Instruments* and IFRS 7 *Financial Instruments: Disclosures* relating to:

(a) derecognition of financial liabilities settled through electronic transfer;

(b) assessment of contractual cash flow characteristics in classifying financial assets; and

(c) disclosure of information about some financial instruments.

10 There are seven sections in the exposure draft, each with explanatory material and corresponding numbered questions. Staff have considered all feedback received in providing their recommendations to the Board.

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?

<u>Stakeholder feedback and staff analysis</u>

11 In September 2021, the IFRS Interpretations Committee (IFRS IC) was asked to provide guidance on whether an entity should derecognise its trade receivable and recognise cash on the date the cash transfer is initiated by the customer (trade date) or on the date the cash transfer is settled (settlement date).

12 The IFRS IC concluded that IFRS 9 addresses this question in 3.2.3(a) and 3.1.1. Accordingly, an entity would derecognise the trade receivable on the date its contractual rights to the cash flows from the financial asset expire (a question of fact but usually when the entity receives the cash) and recognise the cash when the entity becomes a party to the contractual provisions of the instrument (usually when the entity receives the cash into its bank account). If, in some cases, this means the receivable is derecognised before the cash is recognised, the entity might recognise another financial asset, such as a right to receive cash from the customer's bank.[2]

13 IASB stakeholders expressed concern that what (in most cases) would be settlement date accounting would cause undue disruption to long-standing accounting practices and have unintended consequences, particularly for the derecognition of accounts payable. Accordingly, at its October 2022 meeting, the IASB agreed to explore allowing entities to make an accounting policy choice to derecognise a financial liability before the settlement date when using an electronic transfer system. These amendments follow from this decision.

14 The proposed 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)[3]. Four stakeholders discussed this clarification. One stakeholder observed that specifying settlement date accounting seems a move away from a principles-based approach and could have unintended consequences. Three stakeholders thought there are many exceptions to settlement date accounting in IFRS 9, and B3.1.2A might cause confusion.

15 Staff suggest that the clarification in B3.1.2A may not be necessary and could create further difficulty in applying existing requirements. The wording of the clarification could be considered more holistically at a later date.

16 The proposed 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. Stakeholders discussed the timing of derecognition, noting that B3.3.8 refers only to the financial liability and not the corresponding cash payment.

(a) Six stakeholders discussed that if a financial liability is derecognised (debited) before the settlement date as per B3.3.8, the corresponding credit entry was unclear, given the overarching requirement to apply settlement date accounting for all financial assets (B3.1.2A). The stakeholders discussed that if the entity cannot stop the cash payment or access the cash once the electronic payment is initiated (B3.3.8 (a) and (b)), they assume an entity would credit cash. However, the stakeholders were not sure this is clear from the wording in the guidance and would like the matter to be clarified.

(b) Three stakeholders discussed that the derecognition of a trade payable by an entity before the settlement date would not match their counterparty's derecognition of the corresponding receivable.

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[2] For a full discussion see: https://www.ifrs.org/content/dam/ifrs/meetings/2022/june/ifric/ap03-cash-received-via-electronic-transfer-ifrs-9.pdf

[3] A regular way purchases or sale of of financial assets shall be recognised and derecognised, as applicable, using trade date accounting or settlement date accounting (3.1.2). A regular way purchases or sale is defined as a purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned (Appendix A).

(c) Two stakeholders said B3.3.8 is overly complicated and does not solve the problem created in the September 2021 IFRS IC tentative decision. They suggested simply permitting trade date accounting for payables.

17 Staff note that the IASB discuss in BC13-21 why they have not provided further clarification regarding the derecognition of the cash (financial asset) side of the transaction. This would be accounted for in accordance with the existing requirements in (3.2.3). Staff do not think it is necessary that the timing of recognition and derecognition be the same for the entity and the counterparty. This is because an entity does not base its accounting on what a counterparty has done but instead assesses its contractual rights and obligations (see also BC18).

18 Para. B3.3.8(a)-(c) 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.

(a) Four stakeholders discussed the requirements that after a payment is initiated, an entity should not be able to withdraw, stop or cancel the payment (B3.3.8(a)) and should have no practical ability to access the cash(B3.3.8(b)). Two stakeholders said that the requirements are difficult to ascertain for Australian entities. For example, the answer may be different for different banks depending on their systems, and even within a single organisation, it could differ depending on how a payment is initiated and the system used to execute the transaction. For example, one stakeholder thought most electronic payments could technically be stopped, meaning B3.3.8(a) could lead to unintended consequences. However, another stakeholder thought that most electronic payments are instantaneous and cannot be stopped and that cash cannot be accessed once the payment is made.

(b) Seven stakeholders discussed the wording of B3.3.8(a), observing that it appears legalistic, and one way to avoid unintended consequences could be to change 'no ability' to 'no practical ability' (similar to B3.3.8(b)). They also discussed how auditors might approach such legalistic wording: possibly requiring a legal opinion. One stakeholder suggested that an alternative could be to remove B3.3.8(a) and instead rely upon B3.3.9, which requires settlement risk to be insignificant, the payment to follow a standard administrative process, and the time to settlement to be short.

(c) One stakeholder suggested further outreach with banks to consider possible unintended consequences of the wording employed in B3.3.8(a) and (b).

19 Staff note that a financial liability (other than a regular way purchase or sale) is derecognised when the obligation is extinguished, i.e., when the obligation specified in the contract is discharged or cancelled or expires (3.3.1). The proposed paragraphs B3.3.8(a) and (b) are, therefore, entity-specific criteria that establish eligibility for the derecognition of relevant transactions prior to settlement. Accordingly, staff agree with the intent of B3.3.8(a) and the explanation in BC28 that an obligation is not extinguished if an entity can stop the payment once it has been initiated. For example, if the bank has not yet transferred the cash.

20 Similarly, it is explained in BC31 that the requirement in B3.3.8(b) for an entity to have no "practical ability" to access the cash (after the payment instruction is initiated) is intended to address the situation where although cash might still be part of the entity's cash balance, i.e., is not yet transferred, it is not part of the 'available' balance in the entity's bank records. However, it is unclear what "practical ability" means in this context. Staff support the reasoning in BC32 that the entity should have no ability to access or direct use of the cash once payment is initiated.

21 To avoid an overly legalistic interpretation of B3.3.8(a), staff think the IASB might consider additional outreach, particularly with banks and auditors, to mitigate possible unintended consequences. Relatedly, staff do not understand why B3.3.8(b) refers to the entity having no 'practical' ability, i.e., why is the test different for these two criteria? One option could be for both requirements to refer to a 'practical ability' with the term defined narrowly in the Basis for Conclusions.

22 Paragraph B3.3.8(c) would require there is an insignificant settlement risk associated with the electronic payment system. B3.3.9 clarifies this requirement.

(a) Three stakeholders asked what it means (in B3.3.9) that the period between initiating a payment instruction and the cash being delivered must be "short." For example, one stakeholder said the timeframe should not allow financing arrangements such as factoring where the entity may not know if the financier has paid the supplier.

(b) One stakeholder suggested B3.3.9 could be provided as an example rather than as a bright line.

(c) One stakeholder suggested explaining the transitional impact on cash flow statements if, for example, entities currently do not recognise their cash payments until the supplier receives it (i.e., the actual settlement date when the obligation is extinguished).

23 Staff agree that it would be helpful for the IASB to define what constitutes a 'short' time between the initiation of payment and its settlement.

Staff recommendations

24 Staff recommend that the Board agree with the intent of the proposed clarifications but request the IASB to consider the following:

(a) Paragraph B3.1.2A proposes 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). The Board might suggest additional outreach concerning this clarification. For example, the proposed clarification may not be necessary or could have unintended consequences.

(b) Paragraphs B3.3.8(a) and (b) are the entity-specific criteria establishing eligibility for derecognition before the settlement date of financial liabilities settled through electronic transfer. To avoid an overly legalistic interpretation of B3.3.8(a), the Board might suggest additional outreach, particularly with banks and auditors, to mitigate possible unintended consequences due to the wording. Relatedly, it is not clear why B3.3.8(b) refers to the entity having no "practical ability" to access the cash for settlement, which appears inconsistent with the IASB's views expressed in BC32.[4] Both subsections could refer to the entity having no "practical ability" if the term were defined narrowly.

[4] BC32: In the IASB's view, it would be inappropriate for an entity to deem a financial liability to be discharged if the entity could still access or direct the use of the cash to be used to settle the liability. If an entity has the practical ability to access the cash for a purpose other than settling the financial liability, it could neither be considered that the entity has delivered cash (as required for settlement date accounting by paragraph B3.1.6 of IFRS 9) nor that the entity has discharged the liability by paying with cash (as required by paragraph B3.3.1(a) of IFRS 9).

(c) Paragraph B3.3.9 clarifies the meaning of 'insignificant' settlement risk in B3.3.8(c). The Board might suggest the IASB defines what is meant by a 'short' time between when a payment is initiated and its settlement.

Question for Board members
Q1 Do Board members agree with the staff recommendations in paragraph 24? If not, what would Board members suggest?

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?

Stakeholder feedback and staff analysis

25 The existing B4.1.7A explains that contractual cash flows that are solely payments of principal and interest (SPPI) are consistent with a 'basic lending arrangement.' In a basic lending arrangement, the main components of interest are consideration for the time value of money, credit risk, liquidity risk, costs and profit margin. The proposed B4.1.8A clarifies that some payment types are inconsistent with the definition of a basic lending arrangement, for example, if they include compensation for risks or market factors that are not typically considered to be basic lending risks or costs (for example, a share of the debtor's revenue or profit), or if it is not aligned with the direction and magnitude of the change in basic lending risks or costs.

(a) Three stakeholders said that the wording of B4.1.8A is circular, and it is difficult to understand what this paragraph actually means. These stakeholders do not understand how this paragraph helps to clarify the classification of loans with ESG related contingent features. For example, they do not understand how the amendments in B4.1.8A and B4.1.10A lead to the illustrative example in B.4.1.13.

(b) Paragraph B4.1.8A says, "… 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." Three stakeholders thought evaluating 'magnitude' could be subject to wide interpretation. For example, when interest rates are low, a small change can have a greater percentage effect and, therefore, greater magnitude. One stakeholder requested that the IASB clarify that the order of magnitude might be assessed qualitatively. Another stakeholder noted that it was unclear, how this explanation relates to the guidance on leverage in B4.1.9[5] which also clarifies cash flow characteristics of some financial assets, that cannot be subsequently measured at amortised costs.

26 Staff suggest that the IASB reconsider the wording in B4.1.8A, noting that the explanations in the Basis for Conclusions are clearer than the proposed amendments. For example, BC47 says that the elements of interest specified in 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. This would address the main concern of Australian stakeholders in their responses to the RFI.

27 Additionally, staff think the wording in 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."

28 The existing B4.1.10 explains that if a financial asset contains contractual terms that change the timing or amount of contractual cash flows (contingent events), the entity must determine whether the contractual cash flows that could arise are SPPI. The proposed B4.1.10A clarifies that to be consistent with SPPI, the occurrence of a contingent event must be specific to the debtor. This is more restrictive than B4.1.10, where the nature of the contingent event (including whether it is specific to the debtor) is indicative rather than determinative.

(a) Six stakeholders asked how the requirement that a contingent event be specific to the debtor would apply to a group. For example, if 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.

(b) One stakeholder noted that in a group context, credit risk is not evaluated at a specific debtor level. Accordingly, the stakeholder asked if the requirements of B4.1.10A could have broader implications.

(c) Two stakeholders asked how would the requirement that a contingent event needs to be specific to the debtor apply in the context of Australian emissions reporting. For example, targets based upon Scope 1 (direct) emissions are clearly related to the debtor, Scope 2 (indirect) emissions are less directly connected, and Scope 3 are less directly connected again (economy-wide indirect emissions).[6]

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[5] B4.1.9: Leverage is a contractual cash flow characteristic of some financial assets. Leverage increases the variability of the contractual cash flows with the result that they do not have the economic characteristics of interest. Stand-alone option, forward and swap contracts are examples of financial assets that include such leverage. Thus, such contracts do not meet the condition in paragraphs 4.1.2(b) and 4.1.2A(b) and cannot be subsequently measured at amortised cost or fair value through other comprehensive income.

[6] See: [Greenhouse gases and energy (cleanenergyregulator.gov.au)](https://www.cleanenergyregulator.gov.au)

(d) Two stakeholders thought B4.1.10A could imply that events where costs specific to the creditor can be passed to a borrower, such as regulatory or tax events, would fail SPPI.

29 Staff question whether the IASB intends to fail loans on SPPI due to (say) additional cost clauses that are creditor (lender) specific when the lender's costs of providing the loan are usually part of a basic lending arrangement. Alternatively, indirect costs would usually be included in the profit margin component of a basic lending arrangement (B4.1.7A).

30 Paragraphs B4.1.13 and B4.1.14 provide two simple examples of how the SPPI test would be applied where a contingent event is specific to the borrower or is market linked. Three stakeholders suggested that having additional guidance or examples reflecting more complex ESG metrics or different types of contingencies would be helpful. For example, one stakeholder asked how the requirements might apply for different types of contingencies, such as changes in interest rates due to changes in the borrowers' credit rating or when the bank has the contractual right to pass on additional costs they might incur that are specific to the debtor.

31 Staff agree that the proposed examples in B4.1.13 and B4.1.14 are straightforward, and more complex or judgemental examples would be helpful.

Staff recommendation

32 Staff recommend that the Board agree with the intention of the proposed clarifications but request the IASB to consider that:

(a) Stakeholders found the wording in B4.1.8A unclear, while the explanations in the Basis for Conclusions (BC47 and BC52) are clearer than the proposed amendments. The Board might suggest the IASB reconsider the wording in B4.1.8A.

(b) Paragraph B4.1.10A clarifies that to be consistent with a basic lending arrangement, the occurrence of a contingent event must be specific to the debtor.

(i) However, there is no discussion in the Basis for Conclusions of how this would apply to a group. For example, if 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.

(ii) It appears that the IASB intends loans with additional cost clauses that are creditor specific to fail the SPPI test, even though the lender's costs of providing the loan and profit margin are part of a basic lending arrangement. The Board might request the IASB to provide further clarification.

(c) The examples in B4.1.13 and B4.1.14 are simple, and stakeholders requested additional examples that involve more complex judgement. For example, stakeholders asked how the requirement for the contingent event to be specific to the debtor would apply as the distance between the debtor and the event becomes attenuated.

Question for Board members

Q2 Do Board members agree with the staff recommendation in paragraph 32? If not, what would Board members suggest?

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?

Stakeholder feedback and staff analysis

33 The IASB explains in BC74 that stakeholders responding to the RFI asked them to clarify the meaning of non-recourse features, particularly 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.

34 Two stakeholders raised concerns with the exposure draft proposals amending B4.1.16 and adding B4.1.16A. For example, B4.1.16 currently 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 B4.1.16A, which says, "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]. The stakeholders thought the both/and requirement might be a change rather than a clarification. For example, a financial instrument whose payments at maturity are exposed to non-basic lending risks or costs would no longer have non-recourse features. One stakeholder said that the current guidance works and should not be changed.

35 However, four stakeholders thought the proposed clarification reflects current practice. One of them thought it might be a change; however, they thought that where there are non-recourse features, the requirement to evaluate the sufficiency of underlying cash flows (B4.1.17) and the proposed B4.1.7A (that further clarifies the sufficiency of the underlying cash flows) would help.

36 Staff think that the 'both/and' requirements in B4.1.16A might (in some cases) be more restrictive than current requirements and should be further evaluated.

37 Staff also suggest that the IASB reconsider the wording in B4.1.16A, noting that the explanations in BC75 more clearly answer the question asked by stakeholders in BC74 (outlined above). Specifically, 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 only has recourse to the debtor for repayment. Staff think this explanation in BC75 might also be less restrictive than the wording in B4.1.16A.

Staff recommendations

38 Staff recommend that the Board agree with the intention of the proposed clarifications but request the IASB to consider the following:

(a) Whether the IASB intends the clarification in B4.1.16A to be more restrictive in some cases than current practice and to consider the need for additional outreach to evaluate possible unintended consequences.

(b) The Board might suggest the IASB reconsider the wording in B4.1.16A to align more closely with BC75, which more clearly answers the question raised by stakeholders (in BC74). This explanation might also be less restrictive than the current wording in B4.1.16A.

Question for Board members

Q3 Do Board members agree with the staff recommendation in paragraph 38? If not, what would Board members suggest?

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?

Stakeholder feedback and staff analysis

39 Two stakeholders said the new guidance seems very specific and discussed whether it might encourage structuring.

40 One stakeholder agreed with the proposals but requested clarification of the circumstances where it would apply. For example, under B4.1.20A, if a lender initially holds the junior debt but sells it later, it could have unintended consequences because, in IFRS 9, the SPPI test is not reapplied after initial recognition.

Staff recommendations

41 Staff recommend that the Board agree with the proposed clarifications while observing that the wording of the proposed B4.1.20A is quite specific. The IASB might consider additional outreach to identify possible unintended consequences.

Question for Board members
Q4 Do Board members agree with the staff recommendation in paragraph 41? If not, what would Board members suggest?

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

Stakeholder feedback and staff analysis

42 The existing disclosures for investments in equity instruments designated at fair value through other comprehensive income (FVOCI) are in IFRS 7 paragraphs 11A and 11B.

43 The changes proposed for 11A would remove the current requirement to disclose the fair value of each investment at the end of the period and replace this with the requirement to disclose the aggregate fair value (11A(c)). Further, there would be an additional requirement (11A(f)) to disclose changes in fair value presented in other comprehensive income during the period split between the changes for instruments that have been disposed of or are on hand at the end of the year. The IASB also provided an illustrative example for disclosing equity instruments designated at FVOCI in IG11A and IG11B (pages 40-41 of the ED).

44 Three stakeholders discussed the illustrative example, which would not be a requirement, and entities could apply judgment in presenting the information:

(a) Two stakeholders said that the reconciliation of the cumulative OCI balance (in equity) would be useful to users and thought the reconciliation should be a requirement in the standard.

(b) However, two stakeholders said disclosing cumulative gains and losses on equity instruments disposed of in the period (as shown in the reconciliation) is not required in the standard and would be difficult to do because the exposure draft provides no clarification of how cost should be determined—for example, FIFO or weighted average.

45 Staff think the list of individual disclosure requirements in 11A and 11B are confusing and agree with stakeholders that the reconciliation in IG11B would provide an organising principle in the standard and be more useful to users. While there is currently no requirement for an entity to disclose cumulative gains and losses on equity instruments disposed of in the period (as shown in the reconciliation), staff think this should be a requirement, and entities should be able to develop an appropriate accounting policy for the cost base of equity investments classified at FVOCI.

Staff recommendations

46 Staff suggest that the Board agree with the intention of the proposed disclosures but request the IASB to consider adding a requirement in 11A or 11B for entities to disclose the cumulative gain or loss on equity investments disposed of in the period. The IASB might also consider replacing the current disclosure requirements with the reconciliation presented in IG11A and IG11B.

Question for Board members

Q5 Do Board members agree with the staff recommendation in paragraph 46? If not, what would Board members suggest?

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?

Stakeholder feedback and staff analysis

47 The proposed paragraph 20B requires a narrative description of contingent events (20B(a)) and quantitative information about the range of changes to contractual cash flows that could result from those terms and the gross carrying amount of instruments subject to those terms (20B(b) and (c)). The disclosure is by class of financial instrument (20C). There is no illustrative example of the proposed disclosure in the exposure draft; however, below is an IASB staff example from a recent presentation:

The carrying amount of loans and advances to customers at amortised cost include loans with contractual terms that adjust the interest rate based on the achievement of contractually specified reductions in greenhouse gas emissions by the borrower. The table below sets out the range of reductions in interest rate and the gross carrying amount of the loans with such terms.

Reduction in interest rate (bps per annum)	Gross Carrying Amount (CU million)	
	31 Dec 2022	31 Dec 2021
< 5	500	400
5-10	1,200	1,000
10-15	400	300
> 15	100	50
Total	2,200	1,750

*The IASB is not proposing to include these examples as part of the proposed amendments to IFRS 7. These examples are the based on the staff's interpretation of the proposed disclosure requirements and are included solely for discussion purposes.

48 Six stakeholders had concerns about aspects of the proposed requirements in 20B for contingent events:

(a) Three stakeholders thought entities might have difficulty capturing the quantitative information in 20B(b) and (c) that could be located in different systems across a business. This could make the disclosure very costly. One of the stakeholders observed that the information might be particularly difficult for non-bank lenders to obtain as they tend to be smaller than banks with less sophisticated systems.

(b) Five stakeholders said 20B(b) and (c) might create a lot of work for preparers for uncertain benefits to users. For example, one stakeholder said the information in 20B(b) and (c) might be useful to users but could be too much information or be too aggregated. Another observed that the disclosures in 20B(b) and (c) could be presented in many different ways and would not be comparable between entities.

(c) One stakeholder suggested quantifying the historical effect of changes in cash flows from contingent events could be more useful than future potential effects. It should also be easier for entities to collect this data. For example, it could be difficult for users to know the likelihood of contingencies occurring from the proposed disclosure.

(d) One stakeholder said there could also be concerns 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 20B(b) and (c). The stakeholder suggested that even though amounts might not be material for an entity, some stakeholders could require them to provide the disclosure if it is in an accounting standard. Another stakeholder suggested it might be difficult for an entity to argue that such a disclosure would not be material.

(e) Two stakeholders noted that the requirements in 20B would apply to all contingent events, not just ESG-related contingent events. This could substantially increase the volume of disclosures. One of the stakeholders suggested narrowing the scope.

(f) One stakeholder observed that 20B overlaps with IFRS 7 B10A, which already requires entities to disclose summary quantitative data on their exposure to liquidity risk and changes in cash flows. They thought this overlap might be confusing.

49 Three stakeholders that are users thought the proposed disclosure would be useful. One of them said it would help them to identify the types of contingent events in a loan portfolio and the extent to which entities' cash flows might change as a result. Although the proposed

disclosure is limited in scope, it would give users a starting point to ask questions of management.

50 Staff suggest that the proposed quantitative disclosures in 20B may result in entities having to modify their systems to collect the necessary information for the disclosures and track the information by class of financial assets or financial liabilities. As a result, given the large volumes and diversity of financial instruments with contingent features (not just ESG-linked), staff think that the proposed disclosure requirements could have significant operational challenges and implementation costs. Staff suggest additional outreach to identify the real cost for preparers.

51 Staff also suggest additional outreach may help to evaluate the potential commercial sensitivity of entities being required to disclose the volumes and pricing of their loans with contingent features and the nature of the contingent features.

Staff recommendation

52 Staff recommend that the Board support the intention of the proposed disclosures but ask the IASB to consider additional outreach to evaluate the cost of the proposed disclosures, including the cost (or consequence) of disclosing potentially commercially sensitive information versus the specific benefit to users, including how users would use the information provided.

Question for Board members

Q6 Do Board members agree with the staff recommendation in paragraph 52? If not, what would Board members suggest?

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

Stakeholder feedback and staff analysis

53 One stakeholder suggested the standard should permit voluntary restatement of prior periods. Staff note this is proposed to be permitted in 7.2.48, provided hindsight is not applied.

54 One stakeholder observed that some of the 'clarifications' could result in entities uncovering a prior period error and questioned the order of application of the requirements in the applicable standards. Another stakeholder referred to 7.2.49 and BC107, which say where the initial application of the proposed amendments results in a change to the classification of financial assets, an entity should disclose information about the measurement category immediately before and after the amendments are applied.

55 Staff suggest that errors that are not a result of proposed changes would be accounted for in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Staff recommendation

56 Staff recommend that the Board agree with the proposed transitional requirements.

Question for Board members

Q7 Do Board members agree with the staff recommendation in paragraph 56? If not, what would Board members suggest?

Next steps

57 The comment period to IASB ED/2023/2 closes on 19 July 2023. As there is no further AASB meeting before the comment period close date, staff suggest a comment letter reflecting the Board's decisions from this meeting be finalised out-of-session by the Chair.

The proposed timing is as follows:

During week beginning	Deliverable
14 July 2023	Staff circulate a draft comment letter to the Chair for review.
14 July 2023	The Chair provides comments on the draft letter.
17 July 2023	Staff circulate a revised comment letter to the Chair for further/final comments.
18 July 2023	The Chair reviews and approves the comment letter.
19 July 2023	The comment letter is signed by AASB Chair and submitted to the IASB by 19 July 2023.

Questions for Board members

Q8 Do Board members agree with the staff recommendation that the AASB submission is finalised out-of-session by the Chair?

Q9 Do Board members have any comments or concerns about the proposed timing of the finalisation of the AASB comment letter?