Think Ahead ACCA

ED/2023/2 Amendments to the Classification and Measurement of Financial Instruments

Exposure draft issued by the IASB in March 2023

Comments from ACCA
13 July 2023

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GENERAL COMMENTS

ACCA welcomes the opportunity to provide views in response to the IASB's exposure draft (ED) for the proposed amendments to IFRS 9 and IFRS 7 in relation to *Amendments to the Classification and Measurement of Financial Instruments*.

This was done with the assistance of ACCA's Global Forum for Corporate Reporting.

The proposals in this ED address two types of transactions that are becoming increasingly popular, ie, settlement through electronic payments and ESG-linked loans.

A survey conducted by ACCA found that 70% of respondents are using fintech for money transfer. Payments and lending are significant areas of fintech adoption[1].

Another survey conducted by ACCA found that 6% of respondents are already using green finance. Though not all green finance products will contain contractual terms that may change the timing or amount of future cash flows, the prevalence of financial instruments that contain these contractual terms may increase if more organisations turn towards green finance products in their transition to net-zero. In the same survey, 22% said they are likely to use green finance and 41% said they may use it. That is despite only 10% having a good level of knowledge/understanding or being an expert in green finance[2].

We are supportive of the proposed principle-based approach to determine whether contractual cash flows, including those with ESG-linked or similar features, are solely payments of principal and interest on the principal amount outstanding. The key principle being whether the changes in the timing or amount of contractual cash flows are consistent with a basic lending arrangement. As new instruments are introduced in the market, a principle-based approach would allow instruments with similar features to be consistently assessed using the same set of requirements. The proposed amendments in the ED will assist preparers in applying requirements in IFRS 9 consistently and thus supporting comparability of financial statements across entities.

The proposed disclosure requirements should provide relevant information to help users understand the significance of changes in contractual cash flows to an entity's financial statements. However, duplication of disclosure requirements should be avoided.

As there could be more than one type of contractual terms that may change the timing or amount of contractual cash flows, we are supportive of disclosure requirements that encourage entities to scale the extent of information to be provided to users.

Our detailed responses to the specific questions asked are set out below.

[1] ACCA (2022), *Fintech: State of Play – Opportunities For Finance Professionals*
[2] ACCA (2023), *Green Finance Skills: The Guide*

RESPONSES TO SPECIFIC QUESTIONS RAISED

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?

ACCA response – Question 1

We support the proposal in paragraph B3.3.8 to allow an entity to discharge a financial liability before the settlement date if, and only if, the entity has initiated the payment instruction and meeting all the criteria in B3.3.8(a) – (c).

The three criteria are sensible and taken together, these criteria imply an entity has delivered cash, through an electronic payment system, to the creditor.

However, the criterion in paragraph B3.3.8(a) that says *"the entity must have no ability to withdraw, stop or cancel the relevant payment instruction"* may be overly strict so that it will, by default, exclude electronic payment systems that allow entities a short period of time (eg, within 24 hours) to stop or cancel a payment instruction. We suggest amending the criterion to *"the entity must have not withdrawn, stopped or cancelled the relevant payment instruction subsequently".* In this case, the entity is still committed to transferring cash through an electronic payment system to settle a liability.

In addition, the terms, 'settlement risk' and 'electronic payment system' have not been defined in the IFRS Accounting Standards. We suggest providing a clear definition of 'settlement risk' and 'electronic payment system' to aid consistent application of B3.3.8. As 'settlement risk' is already explained in paragraph BC 33 of the ED, the IASB should consider placing this explanation within the standard.

The accompanying paragraph B3.3.9 that explains when settlement risk is deemed insignificant is helpful in applying paragraph B3.3.8(c).

We also support the proposal in paragraph B3.3.10 that requires an entity to apply the requirements in paragraph B3.3.8 to all settlements made through the same electronic payment system. We believe clarifying this requirement will prevent cherry-picking. However, we suggest clarifying that an entity should assess each electronic payment system that an entity elects to apply paragraph B3.3.8. This will be important for entities that use several electronic payment systems, either domestically or in multiple jurisdictions.

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?

ACCA response – Question 2

Paragraph B4.1.8A

The proposed paragraph B4.1.8A helps entities in assessing if contractual cash flows of a financial asset are consistent with a basic lending arrangement when applying paragraphs B4.1.7 and B4.1.7A. The existing paragraph B4.1.7A already sets out the different components of interest. Clarifying that assessment should 'focus on ***what*** an entity is being compensated for, rather than ***how much*** compensation an entity receives' should help entities determine if contractual cash flows are consistent with a basic lending arrangement. Therefore, we support the proposed paragraph B4.1.8A.

Paragraph B4.1.10A

The requirement for an entity to assess the nature of any contingent event (ie, the trigger) that would change the timing or amount of the contractual cash flows in assessing whether the contractual cash flows are solely payments of principal and interest already exist in paragraph B4.1.10.

We are supportive of the proposed paragraph B4.1.10A which clarifies:

- the assessment of the change in cash flows due to a specified contingent event shall be done irrespective of the probability of the contingent event occurring (except for non-genuine contractual terms as described in paragraph B4.1.18).

- the occurrence (or non-occurrence) of the contingent event must be specific to the debtor. This removes doubt on whether other market-driven events can be considered.

- for the ‘occurrence of a contingent event’ to be deemed ‘specific to the debtor’, the occurrence of the contingent event shall depend on the debtor achieving a contractually specified target, even if the same target is included in other contracts for other debtors.

- the contractual cash flows should not represent an investment in the debtor or an exposure to the performance of specified assets. We note this last sentence is linked to paragraphs B4.1.15 and B4.1.16, where these conditions already exist in IFRS 9.

These clarifications are helpful in understanding and applying the requirements in paragraph B4.1.10.

However, we suggest the IASB clarify:

- the term ‘contingent event’ so entities will understand what constitute a contingent event. This term is not defined in the IFRS Accounting Standards, though it already exists in paragraph B4.1.10 of IFRS 9.

- if it intended to exclude considering the probability of a non-genuine contractual terms occurring, or to exclude non-genuine contractual terms from the assessment entirely.

- the concept of ‘specific to the debtor’. We anticipate room for interpretation in practice and would suggest clarifying whether a contingent event (eg, an ESG-linked factor) is still considered ‘specific to the debtor’ if its occurrence is dependent on ‘achieving a contractually specified target’:

a) as a group at consolidated level, or
b) by its parent, or
c) by its subsidiary, or a fellow subsidiary.

- the accounting treatment when the contingent event is imposed by a government on the entity and achieving the contingent event is mandated by law. We suggest providing guidance for the application of paragraphs B4.1.10 and B4.1.10A for more complex scenarios, like in this case.

Paragraph B4.1.13 and B4.1.14

We support adding more examples to illustrate contractual cash flows that are solely payments of principal and interest on the principal amount outstanding (SPPI) and those that are not.

We also support adding examples ‘Instrument EA’ in paragraph B4.1.13 and ‘Instrument I’ in paragraph B4.1.14 to complement other existing examples. We suggest expanding the description of ‘Instrument EA’ to include considerations that the IASB had in paragraph BC64, whereby a creditor may insert the same contingent event in all its contracts, but the occurrence of the contingent event can be specific to the debtor. For ‘Instrument I’, we suggest specifying in the analysis of the instrument that the changes in the contractual cash flows is triggered by the

occurrence of a contingent event (ie, a market-determined carbon price index reaching a contractually defined threshold) that is not specific to the debtor, and depend on factors that are unrelated to the debtor. This reflects considerations that the IASB had in paragraph BC65 and specifying them in this example will help with the understanding and application of paragraph B4.1.10A.

In addition to the proposed examples, we suggest adding examples that are more complex. For instance, those illustrating:

- investments in the debtor, or
- ESG-linked factors attached to another entity within the group, such as at the debtor's parent, or subsidiary, or fellow subsidiary, or
- government-imposed ESG-linked factor.

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?

ACCA response – Question 3

We support the proposed amendment to paragraphs B4.1.16 and B4.1.16A, particularly in clarifying, for a financial asset to have non-recourse feature, 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 asset and in the case of default.

We note that these proposed amendments aim to differentiate non-recourse features and collateralised borrowings. We suggest including paragraph BC75 within the standard to explain the difference between financial assets with non-recourse features and financial assets that are secured by collaterals.

In addition, we suggest including paragraph BC77 within the standard to illustrate a situation in which a creditor has the contractual right to require a debtor to pledge additional assets if specified assets do not generate sufficient cash flows or when their value decreases below a specified threshold. In particular, adding the sentence, *'In such situations, the financial asset does not have non-recourse features because the creditor has recourse to the debtor to secure its contractual right to the cash*

flows from the financial asset'. This clarification is important in distinguishing recourse and non-recourse features and will provide greater clarity.

We are supportive of adding conditions (a) and (b) in paragraph B4.1.17A to consider the cash flows generated by the underlying assets (the non-recourse features) when assessing whether the contractual cash flows of a financial asset with non-recourse features are solely payments of principal and interest on the principal amount outstanding. However, it is not immediately clear why an entity needs to consider the legal and capital structure of the debtor in its assessment. We suggest expanding the proposed paragraph B4.1.17A to provide more clarity by including the rationale as explained in Paragraph BC 76.

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?

ACCA response – Question 4

Clarifying the assessment for contractually linked instruments is helpful for entities in determining the classification of such instruments.

We support clarifying what constitute contractually linked instruments in paragraph B4.1.20 and illustrating the payment structure that results in tranches having non-recourse features.

Paragraph B4.1.20A is helpful in clarifying the accounting for transactions that do not contain multiple contractually linked instruments, despite a transaction containing multiple debt instruments.

We also support the proposed clarification in paragraph B4.1.23 to include financial instruments that are not entirely within the scope of IFRS 9 in applying the requirements in paragraph B4.1.22. Providing examples of such instruments, ie, lease receivables that have 'contractual cash flows that are equivalent to payments of principal and interest on the principal amount outstanding', will be helpful for preparers.

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?

ACCA response – Question 5 The proposed amendment to paragraph 11A(c) of IFRS 7 leaves room for interpretation. If the intention is to disclose the aggregate fair value of equity instruments designated at fair value through other comprehensive income (FVOCI), the requirement should be specific. We support the proposed disclosure in paragraph 11A(f) of IFRS 7.

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?

ACCA response – Question 6 We are supportive of the proposed paragraphs 20B and 20C of IFRS 7 for financial assets only. The proposed disclosures enable users to understand the nature and

the significance of contingent events that cause the change in timing or amount of contractual future cash flows.

However, the scope of the proposed disclosures appears to be wide and could pose practical challenges to entities that hold many instruments that fall within its scope. We suggest clarifying the scope of the proposed disclosures such that not all contingent events specific to the debtor would fall within the ambit of paragraph 20B.

With regard to financial liabilities, the proposed disclosures required in paragraph 20B appear to overlap with the existing paragraph B10A of IFRS 7 which already requires an entity to provide quantitative information that enable users of its financial statements to evaluate the extent of the risk of cash outflows that could either occur significantly earlier, or of significantly different amounts from the contractual maturity analyses disclosed in accordance with paragraph 39 of IFRS 7. Therefore, we suggest excluding financial liabilities from the requirements of the proposed paragraphs 20B and 20C.

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?

ACCA response – Question 7

We are supportive of the retrospective application of the proposed amendments to IFRS 9, and the requirement not to restate comparatives.

We support the disclosure of information regarding the measurement of financial assets immediately before and after the application of the proposed amendments to enable users to understand the effects of the classification of financial assets on an entity's financial statements. Hence, we are supportive of paragraphs 7.2.47 – 7.2.49.

We also support the proposal in paragraph 44JJ of IFRS 7 that does not require an entity to restate comparative information.