Applying IFRS

IFRS 9 Post Implementation Review – progress to date

March 2023

Building a better working world

Contents

What you need to know

- As of March 2023, the IASB (International Accounting Standards Board, or the Board) has completed its discussions on the topics put forward in the Post Implementation Review (PIR) for IFRS 9 *Financial instruments* (IFRS 9) with respect to classification and measurement. It has now published its Project Report and Feedback Statement, which summarises the steps taken, topics discussed, and tentative conclusions reached.

- To address issues arising from the application of the contractual cash flow characteristics requirements, the IASB has commenced a high-priority standard-setting project to develop additional application guidance and examples. The objective is to clarify the principles in IFRS 9 in order to address the application challenges identified with regard to financial assets with Environmental, Social or Governance (ESG) linked features.

- The Board also proposes adding qualitative and quantitative disclosures to IFRS 7 *Financial Instruments: Disclosures* (IFRS 7) for contingent events that could change the amount or timing in respect of contractual cash flows for financial assets and financial liabilities. These disclosures would include, but not be limited to, ESG-linked features.

- In response to the IFRS Interpretations Committee's tentative agenda decision on cash received via electronic transfer in settlement of a financial asset, the IASB is addressing the matter as a high priority as part of the PIR. The IASB has tentatively agreed to allow an accounting policy choice to derecognise a financial liability before an entity delivers cash on the settlement date, when specified criteria are met. The IASB will also clarify the requirements for the derecognition of financial assets when cash is received via electronic transfer.

- Other matters have been identified by the IASB for standard-setting that are not such a high priority. They are for Contractually Linked Instruments (CLI), to clarify application of the contractual cash flow characteristics assessment, and for the fair value changes of equity instruments presented in other comprehensive income rather than profit or loss, to propose additional disclosures.
- The IASB expects to publish a single exposure draft (ED) combining all of these proposed amendments to IFRS 9 and IFRS 7 by the end of March 2023.
- The PIR of the IFRS 9 impairment requirements commenced in the second half of 2022 and the IASB expects to publish a request for information in May 2023. No date has yet been set for starting the IFRS 9 PIR on hedge accounting.

1. Background

The IASB has divided its PIR of IFRS 9 *Financial Instruments* into three phases: classification and measurement; impairment; and hedge accounting. In 2021, it started the first phase relating to classification and measurement by issuing a request for information (RFI) that asked for views from constituents. In 2022, the IASB began deliberations to discuss and respond to the feedback received. The second phase, dealing with impairment, commenced in H2 2022 with an initial identification and assessment of matters to be examined, which will then be the subject of a RFI that will be published in May 2023.[1] No date has yet been set for the third phase on hedge accounting.

Having considered the evidence presented as part of the PIR on IFRS 9 classification and measurement, the IASB has concluded that the requirements of the standard are working as intended. However, certain pervasive issues were identified for which, in May 2022, the IASB decided to commence a standard-setting project to address them as a high priority.

The responses to the RFI were discussed by the Board at its April 2022 meeting, when deliberations were initiated on issues associated with the contractual cash flow characteristics requirements for financial assets, otherwise known as the Solely Payments of Principal and Interest (SPPI) assessment. In May, the IASB agreed to start a stand-alone standard-setting project to clarify certain aspects of the SPPI assessment, focusing on the issues associated with environmental, social and governance (ESG) linked features and CLI. This was assigned a high priority, a project plan was agreed at the Board's June meeting and, in September, the IASB tentatively agreed the staff's proposed solutions (see section 2 below).

At the June meeting, the IASB also considered feedback relating to equity instruments classified as Fair Value through Other Comprehensive Income (FVOCI) and, when the topic was discussed again in October, the IASB decided to propose requiring additional disclosures in IFRS 7 for amounts recognised in OCI (see section 8 below).

In July, in addition to the ESG-linked instruments, the IASB considered a number of further topics and identified next steps, including:

- Contractually linked instruments (CLIs), for which it was decided to clarify the requirements for assessing the contractual cash flow characteristics (see section 3 below)
- Amortised cost measurement, for which the IASB decided to add a project to the research pipeline to explore providing clarifications on accounting for modification of financial assets and financial liabilities (see section 5 below) and for applying the effective interest rate method (see section 6 below)

In September, the IASB discussed various other topics arising from questions that had been raised by respondents to the RFI and tentatively decided that no further action would be taken as the issues were not widespread or expected to have a material effect (see section 10 below).

At the October meeting the Board discussed the business model assessment and tentatively concluded that, whilst there are some areas of complexity and

[1] IASB Staff Paper AP27, July 2022, Post-implementation review of IFRS 9 – Impairment, Project plan. LINK

judgement is needed to apply the requirements, they are working as intended and no change is necessary (see section 9 below).

In December 2022, the IASB published its Project Report and Feedback Statement on the PIR of IFRS 9 classification and measurement, which summarises the steps taken by the IASB, topics discussed, and tentative conclusions reached.[2] The IASB expects to publish an ED of the proposed changes in March 2023.

In the following sections, we provide a summary of the tentative decisions reached on these topics.

2. ESG linked features

The SPPI test, along with the business model test, determines whether financial assets are classified at amortised cost or at FVOCI, as opposed to at fair value through profit or loss (FVPL).

IFRS 9 explains that, in a basic lending arrangement, consideration for the time value of money and credit risk are typically the most significant elements of interest. Interest can include a return for other basic lending risks (for example, liquidity risk), amounts to cover costs associated with holding the financial assets for a particular period of time and a profit margin. Contractual terms that introduce exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement, such as exposure to changes in equity prices, do not give rise to SPPI cash flows.

There is a growing volume of loans for which the interest rate may vary depending on the borrower's performance against certain ESG targets. The issue is whether the ESG features mean that a loan does not meet the SPPI criteria, if the effect is neither *de minimis* nor a commensurate compensation for changes in the credit risk of that particular asset.

Following the view expressed at the April 2022 meeting and the decisions agreed in the subsequent meetings up to and including September 2022, the IASB staff proposed adding application guidance with respect to the characteristics of a basic lending arrangement.[3] The proposed solution is not only applicable to ESG features, but also covers any financial asset with contingent features and is supplemented by additional disclosures. In arriving at this approach, the IASB considered the following points:

- To assess whether financial assets with ESG-linked features have SPPI cash flows, requires an entity to consider what it is being compensated for, and whether the ESG-linked features introduce exposure to risks or volatility/variability in the contractual cash flows that is inconsistent with a basic lending arrangement.
- In making this assessment, the objective of the SPPI condition is to identify financial assets for which amortised cost provides useful information about the amount, timing and uncertainty of future cash flows of the assets.

[2] Post-implementation Review of IFRS 9—Classification and Measurement Project Report and Feedback Statement. LINK

[3] IASB Staff paper 16A, September 2022, Contractual Cash Flow Characteristics of Financial Assets (Amendments to IFRS 9) General requirements. LINK

- The staff do not believe the components of 'interest' referred to in paragraph B4.1.7A[4] of IFRS 9 to be an exhaustive list of the only possible elements of interest that are consistent with SPPI (nor will such elements automatically meet SPPI). While this paragraph of IFRS 9 indicates that interest can include, in addition to time value of money and credit risk, a return for liquidity risk, amounts to cover expenses and a profit margin, it may also include other elements.
- The IASB considered the importance of maintaining a principles-based approach and the difficulty of identifying every possible element of interest that would be consistent with SPPI, considering any types of financial instruments that may emerge in the future.

The IASB decided to require an entity to assess all contingent features in the same way. There is no distinction between contingent prepayment and extension features and other types of contingent features. ESG-linked features should be treated the same as any other contingent feature.

- In developing the proposed application guidance, the IASB decided to require an entity to assess all contingent features in the same way. For example, there is no distinction between contingent prepayment and extension features and other types of contingent features. In the staff's view, ESG-linked features should be treated the same as any other contingent feature.
- Although the nature of a future event does not in itself determine whether a financial asset's contractual cash flows are SPPI, there is often an important interaction between the nature of the future event and the resulting contractual cash flows. For instance, if the nature of the future event is unrelated to a basic lending arrangement (for example, a particular equity or commodity index reaches or exceeds a particular level), it is unlikely that the resulting contractual cash flows are SPPI, because they are likely to reflect a return for equity or commodity price risk.[5]
- Therefore, the staff consider it critical, when assessing any contingent feature, to assess whether the resulting cash flows reflect a return for risk that is unrelated to a basic lending arrangement. For example, an entity would need to assess whether the ESG-linked features introduce exposure to risks and variability that is not consistent with a basic lending arrangement.
- The staff highlighted that in the basis for conclusions of IFRS 9, the SPPI assessment considers what the lender is being compensated for, and not whether including certain features in a loan is common or widespread in a particular market.[6]
- It is the staff's understanding that ESG-linked adjustments to interest rates are often not determined by considering the risks or ability of the individual borrower to meet specific ESG targets. Consequently, in those cases the ESG-linked features are not intended to compensate the lender for taking on ESG risks. Rather, the ESG adjustment serves as an 'incentive' for the borrower to meet the specified ESG targets. That could be the case, for

[4] IFRS 9 paragraph B4.1.7A '… interest can also include consideration for other basic lending risks (for example, liquidity risk) and costs (for example administrative costs) associated with holding the financial asset for a particular period of time. In addition, interest can include a profit margin that is consistent with a basic lending arrangement…' LINK
[5] IFRS 9 paragraph B4.1.10 '…For example, compare a financial instrument with an interest rate that is reset to a higher rate if the debtor misses a particular number of payments to a financial instrument with an interest rate that is reset to a higher rate if a specified equity index reaches a particular level. It is more likely in the former case that the contractual cash flows over the life of the instrument will be solely payments of principal and interest on the principal amount outstanding because of the relationship between missed payments and an increase in credit risk.' LINK
[6] IFRS 9 Basis for Conclusions, BC4.182(b) '…The IASB also noted that the assessment of interest focuses on *what* the entity is being compensated for (ie whether the entity is receiving consideration for basic lending risks, costs and a profit margin or is being compensated for something else), instead of *how much* the entity receives for a particular element …' LINK

example, if the same level of adjustment was made to the contractual interest rate for borrowers across various industries and various ESG targets. If the contractual cash flows resulting from the ESG-linked feature do not introduce compensation for ESG risks, the staff think that ESG-linked features that are present in a financial asset would not, in themselves, cause the contractual cash flows to be inconsistent with a basic lending arrangement.

- As this assessment can require considerable judgement, the staff believe IFRS 9 should be clarified by adding application guidance to support the consistent application of the SPPI criteria.
- Such guidance should also clarify how the disclosure objectives and principles in IFRS 7 *Financial Instruments: Disclosures* would apply to financial assets with ESG-linked features, including information about an entity's exposure to risks arising from such features and how an entity manages such risks. Enhanced disclosure could provide useful information about ESG-linked features and other contractual terms that could affect the amount or timing of contractual cash flows.

Based on the above considerations, the IASB tentatively agreed to provide additional guidance that contingent features that change the amount and timing of contractual cash flows could be consistent with a basic lending arrangement and, therefore, have SPPI cash flows if:

- The contractual cash flows that could arise from any contingent events are SPPI in all circumstances (i.e., the probability of a contingent event occurring is not considered)
- The contingent event is specific to the borrower
- The timing and amount of any variability in contractual cash flows are determinable and specified in the contract

  And
- The contractual cash flows arising from the contingent event do not represent an investment in the borrower or exposure to the performance of the underlying assets

To illustrate how this would apply in practice, examples will be developed for inclusion in IFRS 9, of contractual terms of a contingent nature that are consistent with a basic lending arrangement and those that are not.

How we see it

We agree with the IASB staff's thought process which describes how ESG features can be consistent with a basic lending arrangement, which is consistent with EY's existing guidance.[7] We also support the staff's tentative decision to provide further application guidance and examples in this area. The proposal to identify whether a contingent feature is specific to a party to a contract echoes the definition of a derivative and its 'underlying'. This approach is well established to identify whether a financial liability has an embedded derivative and provides a good starting point to address the questions posed by ESG-linked features included in financial assets. Whether this represents a clarification of existing guidance or rather is a new approach is currently unclear and is likely to be better understood once the ED is published.

[7] See EY's International GAAP 2023, chapter 43 Financial Instruments: Classification, section 5.4.7 Environmental, social and governance (ESG) linked loans LINK, and section 10.1 Financial assets with ESG-features. LINK

Disclosures

At its meeting in October 2022, the IASB tentatively decided to propose additional disclosures to enable users of the financial statements to better understand the extent of an entity's exposure to these types of instruments.[8] For each class of financial assets and financial liabilities not measured at fair value through profit or loss, the proposed disclosures would include:

- A qualitative description of the nature of the contingent events that could change the timing or amount of contractual cash flows
- Quantitative information about the potential range of changes to contractual cash flows that could result from the contractual terms

  And
- The gross carrying amount of financial assets and amortised cost financial liabilities subject to these contractual terms

How we see it

The proposed amendments for the assessment of ESG-linked features apply in the context of the accounting from a holder's perspective, so apply for the treatment of financial assets. However, the proposed disclosure requirements are for both financial assets and financial liabilities.

The proposed disclosure requirements will capture more financial instruments than just those with ESG features and may require significant work for entities to identify all items in scope and to gather the new information required to be disclosed.

It could be challenging in practice for holders of financial assets and issuers of financial liabilities with contingent features to capture the different outcomes arising from the 'potential range of changes to contractual cash flows that could result from the contractual terms', as this information may not be readily available or have previously been tracked.

3. Contractually linked instruments

IFRS 9 contains guidance on when so-called contractually linked instruments (CLIs) are viewed as satisfying the SPPI criteria. This was designed primarily to address securitisations of debt instruments but feedback from the RFI identified that the scope and meaning of a number of the terms used in the guidance is unclear.

The Staff Paper from the April 2022 meeting sets out their views[9]:

- The key defining characteristic of a CLI is the creation of credit concentrations through the contractual reduction in the tranche holder's right to receive cash flows (including repayment of the principal) after satisfying any tranches that have higher priority of payment than the tranche being assessed.
- The IASB could provide further explanation of the key characteristics of a CLI to clarify the types of contractual arrangements the requirements were intended for. The staff think that such clarification would help ensure

[8] IASB Staff paper 16, October 2022, Disclosure, transition and effective date LINK.
[9] IASB Staff paper 3C, April 2022, Contractual cash flow charcteristics assessment – contractually-linked instruments. LINK

entities apply the relevant requirements consistently, and only to those financial instruments the IASB intended the requirements for.

In addition, questions were asked in the RFI about what constitutes a non-recourse financial asset and how this differs from CLIs, and the application of the SPPI requirements in this regard. The staff note dan important distinction is that a CLI in IFRS 9 is a type of structured financial instrument, whereas having no or limited recourse to the borrower's assets is a feature of a financial instrument. The IASB will develop additional application guidance for this area.

At the meeting in May 2022, the IASB agreed with the staff's recommendation to assign a medium priority to this area as, whilst it is important, it is not pervasive for entities' financial statements.[10]

Following deliberations in May and July, At the September meeting, the IASB tentatively agreed to include guidance to clarify that the unique characteristics of a structure of CLIs are:

- The use of multiple contractually linked instruments
- The presence of non–recourse features
- The prioritisation of payments through a waterfall payment structure
- Concentrations of credit risk that disproportionately reduce contractual rights in the event of cash flow shortfalls

The Board also tentatively agreed to clarify that, for financial assets with non-recourse features[11]:

- The lender is exposed to the performance risk of the underlying asset(s) throughout the life of the instrument both for the payment of the contractual payments as well as in default
- The lender's contractual right to receive contractual payments over the life of the instrument is restricted to the cash flows generated by the underlying asset

It was also tentatively agreed to include examples of relevant factors an entity could consider when assessing the underlying assets or cash flows, such as:

- The legal or capital structure of the borrower
- The extent to which the expected cash flows from the underlying assets exceeds the contractual cash flows on the financial asset

  Or

- Whether there are other sources of finance (i.e., loans) that are subordinated to the loan from the lender

Lastly, the IASB also tentatively decided to clarify that the reference to 'instruments' in paragraph B4.1.23 of IFRS 9 includes financial instruments that are not entirely in the scope of IFRS 9, such as lease receivables.[12]

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[10] IASB Staff paper 3, May 2022, Contractual cash flow characteristics – prioritising PIR Findings. LINK

[11] IASB Staff paper 16B, September 2022, Financial assets with non-recourse features and contractually linked instruments. LINK

[12] IFRS 9.B4.1.23 'The underlying pool must contain one or more instruments that have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.' LINK

At the November meeting, the IASB considered a sweep issue which relates to the scope of transactions to which the CLI requirements apply.[13] The IASB tentatively decided to clarify that when determining whether a transaction is in the scope of the CLI requirements, an entity excludes any instruments held by the transferor of the underlying assets to the issuer.

How we see it

The proposed clarifications should be helpful in addressing the difficulties identified with the CLI requirements and to reduce diversity in practice. We support the IASB's proposals and welcome the clarifications being made at the same time as the other amendments for the SPPI assessment.

4. Other contractual cash flow characteristics issues

These issues were discussed by the IASB in April 2022 and fall into the following categories[14]:

a) Cash flows from bail-in legislation

IFRS 9 explains that, to make the SPPI assessment, the holder of a financial asset analyses the contractual terms of the instrument and does not consider payments that arise only as a result of a national resolving authority's power to impose losses on the holders. That power, and the resulting payments, are not contractual terms of the financial instrument. In contrast, the contractual cash flows would not be SPPI if the contractual terms of the instrument permitted or required the issuer or another entity to impose losses on the holder. The issue is whether an asset would fail the SPPI assessment if the terms of an authority's powers are reproduced in the contract.

Given the similarity between this and some of the issues being debated within the context of the Financial Instruments with Characteristics of Equity (FICE) Project, the IASB tentatively decided to consider this issue subsequent to further developments in the FICE project.

b) Whether adjustments for inflation introduce leverage

The concern is that linkage to an inflation index might cause some loans to fail the SPPI test as the adjustments introduce leverage in the context of recent significant rises in inflation rates. IFRS 9 explains that linking contractual cash flows to an unleveraged inflation index resets the time value of money to a current level and the interest amounts are consideration for the time value of money on the principal amount outstanding. The Staff believe this conclusion remains relevant regardless of the level of inflation.

The Board decided that no further action was required following discussions with members of the Accounting Standards Advisory Forum (ASAF) that suggested the issue was neither widespread nor expected to have a material effect on companies' financial statements.

[13] IASB Staff paper 16A, November 2022, Contractually linked instruments – sweep issue. LINK
[14] IASB Staff paper 3A, April 2022, Contractual cash flow characteristics. LINK

c) Whether rates with government-imposed leveraged factors may be regarded as regulated rates

A concern was raised with respect to financial instruments issued in certain jurisdictions, e.g., Hungary and Poland, which can include a leverage factor imposed by the government. For example, the interest rate of the loans is determined based on 1.3 times the government bond yield at disbursement plus a margin. The question is how to consider such a leverage factor in assessing whether the interest rate is a regulated interest rate, and if it is, whether the rate provides exposure to risks or volatility in the contractual cash flows that is inconsistent with a basic lending arrangement.

The Board decided that no further action was required following discussions with members of the Accounting Standards Advisory Forum (ASAF) that suggested the issue was neither widespread nor expected to have a material effect on companies' financial statements.

d) When a prepayment feature represents reasonable compensation for early termination

A few respondents asked what constitutes reasonable compensation for the early termination of a contract. However, the Board tentatively decided to take no further action because it was made aware of this question as part of the 2017 Prepayment Features with Negative Compensation project and outreach since indicates that practice has become established. Additionally, the PIR feedback raised in this area does not provide specific examples of fact patterns or explanations of divergent views that exist in practice. Therefore, while entities need to apply judgement, the staff believe there is no evidence of diversity with a widespread or material effect.

e) Whether certain types of interest rates include a modified time value of money element

A few respondents to the request for information (RFI) had asked whether particular types of interest rates, for example, compounded risk-free rates, include a modified time value of money element, that would need to be assessed to determine if they are 'significant', in which case, they would fail the SPPI test. The Board tentatively decided to take no further action because it was made aware of this question as part of the 2020 IBOR Reform — Phase 2 project and outreach since indicates that practice has become established to treat these as satisfying the SPPI requirements. Additionally, the PIR feedback raised in this area does not provide specific examples of fact patterns or explanations of divergent views that exist in practice.

5. Modifications of financial assets and financial liabilities

The RFI's feedback received highlighted a number of challenges in applying the modification guidance, including:

- What constitutes a modification (also in connection with the deliberations taken in this respect as part of the amendments to IFRS in response to IBOR reform)
- When a modification leads to derecognition, especially for financial assets

- The difference between partial derecognition and a modification

  And

- Calculating and recognising a modification gain or loss

The Staff acknowledged that the modification requirements have been carried across from IAS 39 *Financial Instruments: Recognition and Measurement* largely unchanged and questions about the application of these requirements have been asked long before IFRS 9 was finalised, particularly for financial assets. The staff recommended that standard-setting rather than other actions from the IASB or the Interpretations Committee, would be required to eliminate diversity in practice and support consistent application of the requirements.

In light of these observations, at the July 2022 meeting the IASB added a standard-setting project to its research pipeline to clarify the requirements in IFRS 9 for modifications of financial assets and liabilities. The staff intend to focus on the following areas[15]:

- What constitutes a modification, including the interaction of (or the boundary between) modifications and the expiry of rights to cash flows
- The sequence or hierarchy of modifications and expiry of rights to cash flows
- Treatment of fees and costs as a result of modifying the original contract

The interaction with the expected credit loss (ECL) requirements in the context of forbearance and loan restructuring was also identified as problematic. Any solution for modifications will need to consider the findings of Phase 2 of the IFRS 9 PIR on impairment. As a result, any changes to IFRS 9 for modifications will likely need to come at the same time as Phase 2 is completed.

How we see it

We welcome the IASB's decision to clarify the modification requirements, particularly for financial assets. Clarifications are expected to reduce the diversity that exists in practice on many of these issues, and the practical complexity in applying the existing requirements. However, considering this diversity, entities will need to follow the developments closely to identify any departure from their existing accounting practices.

6. The effective interest rate

The IASB discussed the PIR feedback at its meeting in July 2022. The staff identified two broad and interdependent application questions[16]:

- How to reflect conditions that are attached to the contractual interest rate in the effective interest rate (EIR)
- How to account for subsequent changes in estimates of future cash flows

[15] IASB Staff Paper 3A, July 2022, Modifications of financial assets and finacnial liabilities. LINK

[16] IASB Staff Paper 3B, July 2022, Amortised cost measurement and the effective interest method. LINK

Both questions have existed for a number of years and predate IFRS 9 but have arisen recently in the context of discussions on TLTRO III,[17] ESG and interbank offered rates (IBOR) reform.

A related challenge is identifying when a subsequent changes to estimated contractual cash flows are accounted for under IFRS 9 B5.4.5[18], because the change relates to a change in a floating market rate of interest. The alternative is that the change would be accounted for by applying IFRS 9 B5.4.6[19], such that the carrying value is updated for the present value of the revised estimated contractual cash discounted at the original EIR, which remains unchanged.

The IASB agreed at its meeting in July, that standard setting is required and agreed to consider developing clarifications in the following areas:

- The term 'market rates of interest' to explain what interest rates or market-based variables of contractual interest rates this relates to
- The term 'floating rate' and the interaction with the term 'market rates of interest'
- The treatment of conditionality attached to the contractual interest rate and how this conditionality affects the cash flow estimate for the purposes of calculating the effective interest rate
- The effect modifications have on determining the EIR

As with modifications of financial liabilities and financial assets discussed above, the intended clarifications for EIR will interact with ECL. As a result, the timing for the clarifications on EIR will need to be considered together with those for phase two of the PIR on ECL.

How we see it

We welcome the IASB's decision to commence standard setting to clarify certain aspects of the EIR calculation. Addressing the application challenges that have arisen will help preparers and facilitate greater consistency and transparency in accounting for changes in estimates of future cash flows affecting instruments at amortised cost.

7. Equity instruments and other comprehensive income

At its meeting in October 2022, the IASB discussed feedback from respondents to the RFI with respect to the accounting for equity instruments and the option to present changes in fair value in OCI rather than profit and loss.[20] Arguments proposed by respondents that the approach in IFRS 9 should be changed included the following:

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[17] Refers to the Targeted Longer-Term Refinancing Operations run by the European Central Bank.

[18] IFRS 9 B5.4.5 'For floating-rate financial assets and floating-rate financial liabilities, periodic re-estimation of cash flows to reflect the movements in the market rates of interest alters the effective interest rate. ' LINK

[19] IFRS 9 B5.4.6 '… The entity recalculates the gross carrying amount of the financial asset or amortised cost of the financial liability as the present value of the estimated future contractual cash flows that are discounted at the financial instruments original effective interest rate …' LINK

[20] IASB Staff paper 3A,October 2022 Equity instruments and other comprehensive income. LINK

- Amounts presented in OCI should be recycled to profit or loss on disposal of the equity investment. Reporting all gains and losses at fair value through profit and loss introduces unrepresentative volatility in the profit and loss, which is inconsistent with a hold to collect or hold to collect and sell business model used by many entities for equity investments. Also, prohibiting recycling of gains and losses could have a detrimental effect on long-term investments if entities' investment strategy and their financing of capital depend on performance measures that relate to the profit and loss.
- Whilst it is appropriate to recognise unrealised gains and losses in OCI, recognising realised gains and losses in profit and loss provides the most relevant depiction of entities' performance.
- Non-recycling of realised gains and losses on equity investments creates an accounting disadvantage for all investments in equity investments compared to debt instruments.
- If recycling from OCI were required, a suitable impairment model could be developed, or the approach from IAS 39 could be reinstated. The IAS 39 approach required an assessment of whether a decline in an investment's value was significant or prolonged to determine if it was impaired.
- The scope of the OCI presentation election should be broadened to include indirect investments in equity instruments and financial assets that are not equity but are ' equity-like' such as puttable instruments.
- The exemption from fair value measurement for unquoted equity instruments whose fair value cannot be reliably measured should be reinstated. This exemption in IAS 39 was removed in IFRS 9.

The IASB tentatively concluded that there was insufficient evidence to justify making changes to IFRS 9 and no further action is required. However, it agreed to propose some amendments to the IFRS 7 disclosure requirements, to increase the usefulness and transparency of information provided about the overall performance of equity investments for which the OCI presentation election is made. These proposed amendments would require disclosure of:

- The aggregated fair value of equity investments for which the OCI presentation option is applied at the end of the reporting period; and

  Changes in fair value recognised in other comprehensive income during the period.

8. Business model assessment

At its meeting in October 2022, the IASB considered feedback from respondents to the RFI on how the business model assessment, which applies for financial assets that pass the SPPI assessment, is being applied in practice.[21] Particular topics considered by the IASB included the following:

- The level at which the business model is assessed within an entity or consolidated group, which may be determined differently by different entities, leading to diversity in practice.

[21] IASB Staff paper 3B,October 2022 Business model assessment LINK

- Whether additional guidance should be provided to identify if sales made from a portfolio of financial assets are more than infrequent in number and more than insignificant in value (either individually or in aggregate)[22].
- To help differentiate between business models, whether to provide a threshold for the level of sales from a portfolio, including the frequency and value of sales, as well as whether there is active buying and selling.
- Introducing a less restrictive reclassification requirement when there is a change to management's intention for individual financial assets within a portfolio of financial assets.
- Whether to provide guidance for when changes to an entity's business model are so significant to its operations and demonstrable to third parties that reclassification should be allowed. Also, specific examples considered for when reclassification could be appropriate included:
  - Loan syndications, where a bank has to hold a portion of a loan it had initially expected to sell
  - Factoring arrangements which involve the sale of trade receivables
  - Internal transfers between business units within the same entity
  - Changes in economic environments, such as Covid-19, that result in changes to entities' business strategies.

Having considered the issues above, the IASB decided to take no further action to clarify the business model assessment as it is considered to be working as intended. The IASB noted that the concerns raised relate to specific transactions rather than fundamental aspects of IFRS 9. As IFRS 9 already provides detailed application guidance on these matters, the IASB is concerned that providing further guidance would risk making the requirements rules based. Also, if the scope of the changes to which the reclassification requirements are applied were broadened, the IASB believe it would increase the complexity of IFRS 9 and make it harder for users to understand the information provided in financial statements.[23]

How we see it

The changes in the economic environment and resulting changes to entities' business strategies that have resulted from the recent geopolitical and macroeconomic uncertainty have given rise to an increase in questions on when reclassifications are appropriate. As the IASB has decided not to address this matter, we believe that practical challenges in applying the IFRS 9 requirements in this area are likely to continue.

[22] IFRS 9. B4.1.3B '…In particular, such sales may be consistent with a business model whose objective is to hold financial assets in order to collect contractual cash flows if those sales are infrequent (even if significant in value) or insignificant in value both individually and in aggregate (even if frequent). If more than an infrequent number of such sales are made out of a portfolio and those sales are more than insignificant in value (either individually or in aggregate), the entity needs to assess whether and how such sales are consistent with an objective of collecting contractual cash flows. …' LINK

[23] December 2022, *Project Report and Feedback Statement, IFRS Accounting Standards, Post-implementation Review, IFRS 9 Financial Instruments–Classification and Measurement*, page 24 LINK

9. Electronic cash transfers as settlement for a financial asset or liability

The discussions on this topic relate to the question first considered by the IFRS Interpretations Committee in September 2021, on cash received via electronic transfer as settlement of a financial asset.[24] Whilst the topic could change the accounting by some entities for the derecognition of financial assets, most of the feedback received by the IASB related to financial liabilities, for which the impact is potentially greater.

At their October 2022 meeting, the IASB agreed to explore narrow-scope standard setting to allow an accounting policy choice for entities to derecognise financial liabilities before their settlement date. At the same meeting, the IASB agreed that it would be appropriate for any necessary narrow-scope amendments to IFRS to be made as part of the IFRS 9 PIR.

At its meeting in November, the IASB tentatively agreed to refine the criteria for when the accounting policy choice for financial liabilities could be applied to require that:

- An entity must have no ability to withdraw, stop or cancel an electronic payment instruction
- The entity must have lost the practical ability to access the cash as a result of the electronic payment instruction
- The settlement risk associated with the electronic payment instruction is deemed to be insignificant. For this to be the case, the payment system used must have the following characteristics:
    - The period between the payment initiation date and settlement date is relatively short, and is standardised for the particular payment system concerned

      And

    - Completion of the payment instruction follows a standard administrative process so that the debtor has reasonable assurance that the transfer will be completed, and the cash will be delivered to the creditor.

How we see it

As only those financial liabilities settled by an electronic payment system are within the narrow scope of the proposed amendment, this implies that all other financial liabilities, such as those settled with cheques and credit cards, would need to be derecognised on settlement date.

In the course of its discussions on this topic, the IASB concluded that the general derecognition requirements in IFRS 9 as they apply to financial assets and financial liabilities would not change. Consistent with this and to address the original question raised to the IFRS IC with respect to the derecognition of financial assets, the IASB decided to amend IFRS 9 to clarify that an entity

[24] For further detail on this topic, see our *IFRS Developments 208, IASB considers IFRS IC Agenda Decision: cash received via electronic transfer* LINK

applies settlement date accounting for the derecognition of financial assets (except for 'regular way' transactions) and financial liabilities.

How we see it

The IASB's tentative decisions to date propose no exception to the requirements of IFRS 9 in response to the question raised to IFRS IC on the derecognition of financial assets using an electronic payment system. Therefore, under the proposed amendments, financial assets would need to be derecognised on settlement date, unless they are subject to regular way accounting. Considering this decision by the IASB, entities should carefully assess whether their accounting for payments received will need to change.

10. Other matters

At its meeting in September 2022, the IASB tentatively concluded that no further action was required for a number of matters, as they are not considered widespread or expected to have a material effect. This includes the following[25]:

- For the derecognition of financial assets, some respondents asked for guidance to help assess whether 'substantially all the risks and rewards' have been transferred. There were also requests to clarify the principles behind 'continuing involvement' accounting
- For contracts to buy and sell non-financial items, some respondents asked to clarify aspects of the 'own use exemption' in IFRS 9, including what 'similar' contract means, when the entity has a practice of settling similar contracts net in cash, and whether a separate 'unit of account' exists when part of a contract qualifies for the own use exemption and part of it does not. Also, guidance was requested for when an entity changes its intention after initial recognition.
- For investments in equity instruments for which an entity has elected to present gains and losses in OCI, some respondents noted that it was not clear whether transaction costs arising on disposal should be recognised in profit and loss or in OCI.
- For financial assets and financial liabilities held for trading, more guidance was requested to encourage consistent application, for example, when the risks associated with structured liabilities are managed by a trading desk, or when an entity has an intention to sell a remaining equity stake (less than 20%) within 12 months.

The IASB also considered questions on applying the requirements for Purchased or Originated Credit-Impaired (POCI) financial assets, including those recognised following the substantial modification of an existing asset, and the appropriate level of granularity to calculate the credit-adjusted EIR on a purchased portfolio of consumer debt. The IASB decided to consider these issues as part of the PIR on the impairment requirements of IFRS 9.

Finally, in November 2022, the IASB considered feedback in relation to financial liabilities and own credit, including the presentation of own credit in OCI for financial liabilities designated at fair value through profit and loss[26]. The IASB tentatively concluded to make no changes to the current requirements.

[25] IASB Staff paper 3,October 2022 Other matters raised in PIR feedback. LINK
[26] IASB Staff paper 3,November 2022 Financial liabilities and own credit. LINK

How we see it

For these other matters, the tentative decisions taken by the IASB that no further action is required will likely mean that the diversity in practice which exists can be expected to continue.

11. Next steps

The IASB has now reached tentative decisions on the topics raised as part of the IFRS 9 PIR on classification and measurement, including the narrow-scope amendment to permit the derecognition of a financial liability before settlement date when using an electronic cash transfer. It has also published its project Report and Feedback Statement, which summarises the steps taken, topics discussed, and tentative conclusions reached.[27]

The IASB plan to publish an ED of the proposed changes in March 2023 with a 120-day comment period.

For the IFRS 9 PIR for impairment, the IASB plan to publish a RFI in May 2023.

How we see it

Given the indicative timetable for publication of the ED and comment period, allowing time for the IASB to discuss comment letter feedback on the ED, it is likely that the final amendments to the classification and measurement of financial instruments under IFRS 9 could be published could be in 2024, or potentially by the end of 2023. That could result in initial application for periods beginning on or after 1 January 2025, with early application likely permitted.

[27] December 2022, Project Report and Feedback Statement, IFRS Accounting Standards, Post-implementation Review, IFRS 9 Financial Instruments—Classification and Measurement. LINK

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