INSTITUTE OF PUBLIC ACCOUNTANTS®

1 February 2022

Dr Andreas Barckow
Chair International Accounting Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

By email: commentletters@ifrs.org

Dear Dr Barckow

Re: Request for Information: Post-implementation Review of IFRS 9 Financial Instruments – Classification and Measurement

On behalf of the Institute of Public Accountants (IPA), I am writing to comment on the *Post-implementation Review of IFRS 9 Financial Instruments – Classification and Measurement.*

In general, the IPA has observed the IFRS 9 classification and measurement requirements are working as intended. In our comments to the request for information we have raised areas of concern including:

- The application of Solely Payments of Principal and Interest (SPPI) requirements can often be subjective and result in accounting that is inconsistent with the entity's business model and potentially may give rise to early recognition of income.
- Further guidance is needed in relation to the availability of the fair value through OCI (FVTOCI) option available to equity instrument where the nature of certain investment structures such as mutual funds, exchange traded funds, hybrid/compound financial instruments and other investment vehicles are not clearly equity investments.
- Additional guidance should be included on the application of the requirements for Purchased and Originated Credit Impaired (POCI) loans in relation to the implications arising from the purchase of POCI of consumer credit, and
- The IASB should progress the financial instruments with the characteristics of equity to address the continuing issues with the classification of compound and hybrid financial instruments.

Our detailed comments questions raised in the request for information are included in the attached Appendix to this letter.

If you would like to discuss our comments, please contact me or our technical advisers Mr Stephen La Greca (stephenlagreca@aol.com) or Mr Colin Parker (colin@gaap.com.au), GAAP Consulting.

Yours sincerely

Vicki Stylianou
Group Executive, Advocacy & Policy
Institute of Public Accountants

About the IPA

The IPA is one of the professional accounting bodies in Australia with over 42,000 members and students across 80 countries. Approximately three-quarters of our members either work in or are advisers to the small business and SME sectors. Since merging with the Institute of Financial Accountants UK, the IPA Group has become the largest SME and SMP focused accounting body in the world.

Cc Chair, Australian Accounting Standards Board

Appendix

Question 1 – Classification and measurement

Do the classification and measurement requirements in IFRS 9:

(a) enable an entity to align the measurement of financial assets with the cash flow characteristics of the assets and how the entity expects to manage them? Why or why not?

(b) result in an entity providing useful information to the users of the financial statements about the amount, timing and uncertainty of future cash flows? Why or why not?

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

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

IPA response

In general, the IPA believes the classification and measurement model adopted with the introduction of IFRS 9, better reflects the cash flow characteristics of financial instruments.

Nonetheless the IPA's technical consultants have observed a number of matters that the IPA believes the IASB should consider to ensure classification and measurement of financial instruments is consistent with the manner in which an entity manages financial instruments held. These matters are addressed in our response to the questions below.

The IPA believes particularly the use of "boilerplate" disclosures has limited the utility of disclosures in relation to the application of the business model and solely payments of principal and interest (SPPI).

Question 2 – Business model for managing financial assets

(a) Is the business model assessment working as the Board intended? Why or why not? Please explain whether requiring entities to classify and measure financial assets based on the business model assessment achieves the Board's objective of entities providing users of financial statements with useful information about now an entity manages its financial assets to generate cash flows.

(b) Can the business model assessment be applied consistently? Why or why not? Please explain whether the distinction between the different business models in IFRS 9 is clear and whether the application guidance on the evidence an entity considers in determining the business model is sufficient.

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

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

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

IPA response

The IPA believes in most circumstances the business model requirements of IFRS 9 that pertain to the classification and measurements are operating as intended.

However, the IPA believes there are circumstances where the business model and the SPPI requirements result in outcomes that are inconsistent with the substance of the entity's business. This is most egregious when the financial instrument has a "step-up/step-down" coupon that can be construed to not represent interest in accordance with IFRS 9.4.1.3(b).

The IPA is concerned that while the IASB has provided much in the way of guidance in this application of the SPPI principle, the application of SPPI in practice:

- is extremely subjective in a number of circumstances
- prone to structuring to avoid the use of amortised cost
- encourages the bring forward of revenue by the adoption of fair value through profit and loss, and
- is incapable of adopting to the evolution of the economic characteristics of financial instruments.

The IPA is concerned by giving equivalence to the business model and SPPI when the conditions similar to those enumerated above exist, the financial reporting adopted (i.e. FVTPL) is at odds with the economic nature of the entity.

Question 3 – Contractual cash flow characteristics

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

If in your view, useful information could be provided about a financial asset with cash flows that are not SPPI applying IFRS 9 (that is, an asset that is required to be measured at fair value through profit or loss applying IFRS 9) by applying a different measurement approach (that is, using amortised cost or fair value through OCI) please explain:

(i) *why the asset is required to be measured at fair value through profit or loss (that is, why, applying IFRS 9, the entity concludes that the asset has cash flows that are not SPPI).*

(ii) which measurement approach you think could provide useful information about the asset and why, including an explanation of how that approach would apply. For example, please explain how you would apply the amortised cost measurement requirements to the asset (in particular, if cash flows are subject to variability other than credit risk). (See Section 7 for more questions about applying the effective interest method.)

(b) Can the cash flow characteristics assessment be applied consistently? Why or why not?
Please explain whether the requirements are clear and comprehensive enough to enable the assessment to be applied in a consistent manner to all financial assets within the scope of IFRS 9 (including financial assets with new product features such as sustainability-linked features).

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

(c) Are there any unexpected effects arising from the cash flow characteristics assessment? How significant are these effects?

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

In responding to (a) – (c), please include information about financial instruments with sustainability-linked features (see Spotlight 3.1) and contractually linked instruments (see Spotlight 3-2)

IPA response

The IPA believes, in most circumstances, the SPPI principles are working as intended. However, as noted in our response to Question 2, the IPA believes there are circumstances where the application of SPPI principles result in the classification of financial assets at FVTPL, based on subjective determination of the nature of "interest" payments despite the entities business model being the collection of contractual cash flows.

In relation to sustainability-linked bonds the IPA believes the classification and revenue recognition of such instruments will depend on the interpretation of the SPPI in the context whether the variation of cash flows arising from the attainment (or non-attainment) Key Performance Indicators (KPIs) or Sustainability Performance Targets (SPTs) are within the scope IFRS 9.4.1.3(b).

As noted in our response to Question 2 the IPA has noted diversity in practice in relation to the application of IFRS 9.4.1.3(b) in relation to "step-up/step-down" coupon payments and expects (in the absence of definitive guidance) similar diversity in practice in relation to modifications of cash flows resulting from the attainment or failure to meet KPIs or SPTs in sustainability-linked bonds.

Question 4 – Equity Instruments and other comprehensive income

(a) *Is the option to present fair value changes on investments in equity instruments in OCI working as the Board intended? Why or why not?*

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

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

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

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

(c) *Are there any unexpected effects arising from the option to present fair value changes on investments in equity instruments in OCI? How significant are these effects?*

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

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

IPA response

In relation to "vanilla" equity instruments, the IPA believes the option to record fair value changes in other comprehensive income (OCI) is operating as intended.

However, when dealing with other "equity" like instruments including mutual funds, exchanged traded funds, managed portfolios, redeemable preference shares, hybrid securities etc, there is significant confusion over whether such instruments are eligible for fair value through OCI (FVOCI). The IPA believes that further clarity needs to be provided to preparers to enable the appropriate classification of such instruments. The IPA is of the view the guidance should make it clear that preparers must consider the underlying nature of the financial instrument especially for collective investment such as mutual funds and ETFs when determining the applicability of the FVTOCI option.

The IPA supports the existing stance on recycling of movements in OCI arising from the FVTOCI option for equity instruments and believes there is no compelling argument to change the current position.

Question 5 – Financial liabilities and own credit

(a) *Are the requirements for presenting the effects of own credit in OCI working as the Board intended? Why or why not?*

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

(b) *Are there any other matters relating to financial liabilities that you think the Board should consider as part of this post-implementation review (apart from modifications, which are discussed in Section 6)?*

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

IPA response

The IPA is unaware of any evidence that indicates the IFRS 9 requirements in relation to own credit risk and financial liabilities are not operating as intended.

Question 6 – Modifications to contractual cash flows

(a) *Are the requirements for modifications to contractual cash flows working as the Board intended? Why or why not?*

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

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

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

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

IPA response

The IPA has observed that the requirements of IFRS 9.5.4.3 and IFRS 9.3.3.2 are not consistently applied particularly on the expiration of financial instruments when such financial instruments are rolled-over with the same counterparty. The IPA is particularly

concerned where such rollovers occur where the borrower would not reliably be able to settle the financial instrument in the absence of the existing counterparty. The IPA believes the requirements IFRS 9.5.4.3 and IFRS 9.3.3.2 require greater prominence and improved application guidance to ensure consistent application.

Question 7 – Amortised cost and the effective interest method

(a) *Is the effective interest method working as the Board intended? Why or why not?*

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

(b) *Can the effective interest method be applied consistently? Why or why not?*

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

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

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

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

IPA response

The IPA has observed that the requirements of IFRS 9 in respect to effective interest rates are generally applied on a consistent basis.

However, as noted in our response when the financial instruments include a step-up/stepdown interest rate or coupon depending on the interpretation of the SPPI requirements some preparers will adopt FVTPL rather than amortised cost and therefore not apply the effective interest rate method to such arrangements including those similar raised in Spotlight 7.

The IPA believes the existing guidance in relation to effective interest rates should be sufficient where financial instruments are subject to such arrangements, although there is room for improvement relating to the estimation of effective interest rates in such circumstances.

The IPA notes that many preparers adopt a practical expedient in applying the effective interest rate method by capitalising transaction costs and fees and adopting a straight line basis of recognising the net effect of such fees over the estimated term of the financial instrument. The IPA also notes when such a methodology is adopted a separate line item is often disclosed for unamortised fees or transaction costs.

Question 8 – Transition

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

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

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

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

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

IPA response

The IPA is unaware of any issues that arose on the transition to IFRS 9.

Question 9 – Other matters

(a) Are there any further matters that you think the Board should examine as part of the post-implementation review of the classification and measurement requirements in IFRS 9? If yes, what are those matters and why should they be examined?

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

(b) Considering the Board's approach to developing IFRS 9 in general, do you have any views on lessons learned that could provide helpful input to the Board's future standard-setting projects?

IPA response

The IPA has the following observations in relation to IFRS 9:

Purchased or Originated Credit Impaired (POCI) Loans

The IPA believes there is a need to enhance the guidance on POCI loans. in particular:

- Currently, there is little guidance other than the definition on Credit Adjusted Effective Interest Rates (CAEIR). The IPA is aware that confusion exists as to the nature of CAEIR whereby some preparers and advisors are under the impression it representants an effective

interest rate based on the risk-free rate, no credit risk premia but a “profit margin”. Additional guidance would be helpful in clarifying the nature of the CAEIR.

- Many preparers that are affected by the POCI are purchasers of consumer debt portfolios (credit cards, phone and other utilities etc) rather than individual exposures. The IPA is of the view that there is merit in providing guidance on the appropriate level of granularity required for estimating cash flows, CAEIR, and impairment.

Compound and Hybrid Financial Instruments

The issue of financial instruments with the characteristics of equity (FICE) continues to provide challenges to preparers as well as auditors and advisors. The IPA stresses the importance of the IASB finalising the FICE project in an expedient manner to ensure the consistent classification of such instruments.

Structure of IFRS 9

The IPA has received feedback that the IFRS 9 is a cumbersome standard, many preparers and advisors are unclear as to it scope and find it confusing. Criticism is also levelled on the fact that many of the requirements are hard to follow and circle back on themselves.

The IPA believes that more concise transaction orientated standards may be more appropriate than an all-encompassing standard. The IPA also believes that the IASB needs to be cognisant of the different types of users and the complexity of the transaction they are likely to enter into when determining the content and layout of standards.