IFRS Accounting

Financial Instruments

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Agenda

1 Objective and process of the Post-implementation Review (PIR)

2 PIR of IFRS 9—Classification and Measurement

3 PIR of IFRS 9—Impairment

1. Objective and process of the PIR

PIR—what is the objective?

Objective	To **assess** whether the effects of applying the new requirements on users of financial statements, preparers, auditors and regulators are as intended when the IASB developed those new requirements
Overall, are the requirements working as intended?	**Fundamental questions** (ie 'fatal flaws') about the core objectives or principles—their clarity and suitability—would indicate that the new requirements are not working as intended
Are there specific application questions?	**Specific application questions** would not necessarily prevent the IASB from concluding that the new requirements are operating as intended but may nonetheless need to be addressed, if they meet the criteria for whether the IASB would take further action

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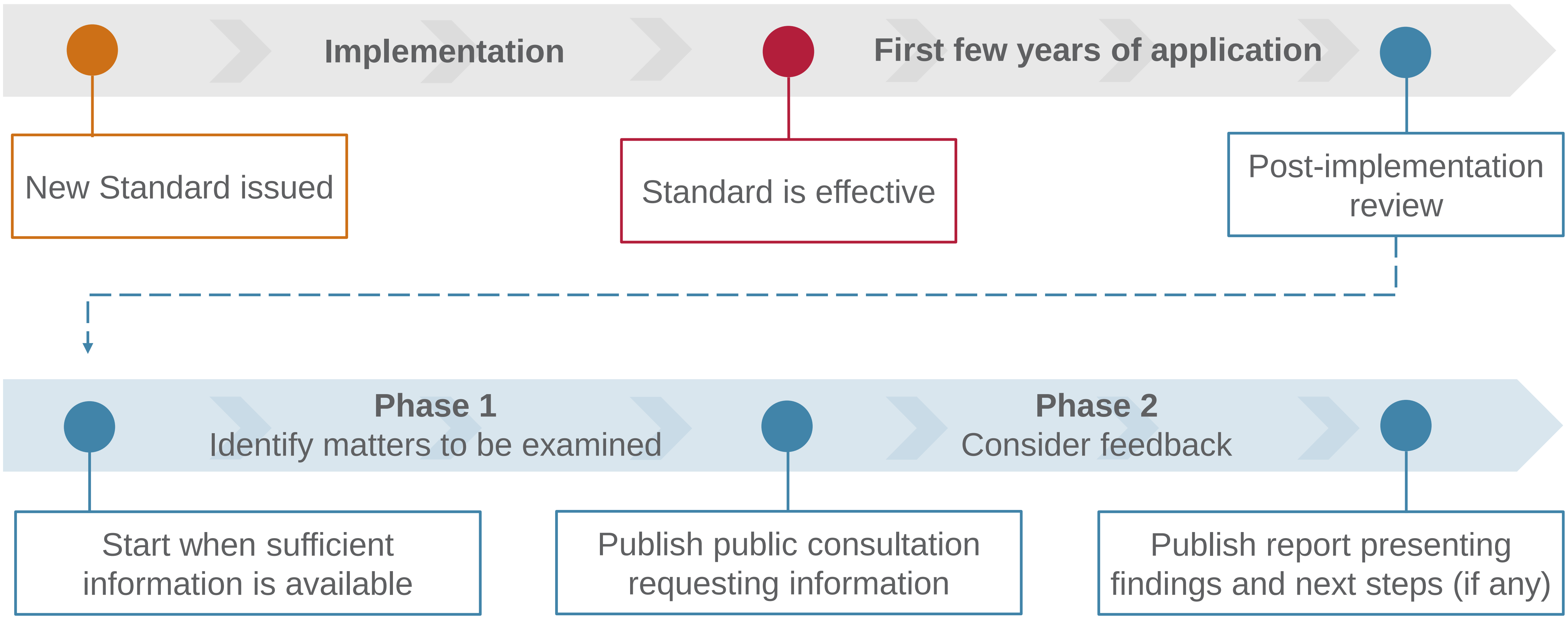
PIR—what is the process?



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PIR—how does the IASB respond to findings?

1 **Consider whether to take action, based on the extent to which:**

- the **objective** of the new requirements is not being met;
- **benefits** to users are significantly lower than expected
- **costs** of applications are significantly higher than expected

2 **Determine the prioritisation of the findings based on the extent to which:**

- finding has **substantial consequences**
- finding is **pervasive**
- finding arises from an issue that **can be addressed** by the IASB or the Interpretations Committee
- the benefits of any action would be expected to **outweigh** the costs

3 **Determining the timing of taking action**

High priority	to be addressed as soon as possible
Medium priority	to be added to the IASB or the IFRIC research pipeline
Low priority	to be considered in the next agenda consultation
No action	require no further action

PIR of IFRS 9

Classification & measurement	**2021** Identify matters to examine — **RFI** **2022** Consider feedback — **Project Report**	See slides 10–17
Impairment	• July 2022, the IASB started the PIR • Q4 2022–Q1 2023, identify matters to examine • H1 2023, aims to publish the RFI with 120 days comment period	See slides 18–27
Hedge accounting	• IASB will consider in H2 2022 the timing of that PIR	

Ask the experts

Riana

- Why is the IASB doing three separate PIRs for IFRS 9?
- Why has the PIR on hedge accounting requirements not started yet?

2. PIR of IFRS 9—Classification and Measurement

PIR of IFRS 9—Classification and Measurement

- The IASB is in Phase 2 of the PIR of the classification and measurement requirements in IFRS 9

H2 2020	H1 2021	H2 2021	H1-H2 2022
IASB starts PIR of **classification and measurement**	Phase 1 outreach and information gathering	Publish consultation document (RFI)	Phase 2 identify issues and take action

Summary of feedback on the RFI

Legend: No significant issues | Some issues raised | Fundamental issues raised

1. IFRS 9 classification and measurement overall
2. Business model
3. Contractual cash flow characteristics (CCFC)
4. Equity instruments and other comprehensive income
5. Financial liabilities and own credit
6. Modifications to contractual cash flows
7. Amortised cost and effective interest method
8. Transition
9. Other matters

Summary of feedback relating to CCFC

Topics	PIR feedback[2]	IASB response[3]
ESG-linked features Interest rate adjusted if borrower achieves pre-determined ESG targets	Not clear how to assess if SPPI[1], leading to diversity in practice	No fundamental changes to principles and no ESG-specific exemption Added **a standard-setting project** to clarify particular aspects of the SPPI requirements **(high priority)**
Contractually linked instruments (CLIs) Concentrations of credit risk created by prioritisation of payments	Questions about scope and application of SPPI requirements to CLIs	

[1] solely payments of principle and interest on the principal amount of outstanding

[2] AP3B, AP3C of the April 2022 IASB meeting [3] AP3 of the May 2022 IASB meeting

Project scope – general SPPI requirements

General SPPI assessment

Clarification of
- underlying principles of SPPI
- whether and how the nature of a contingent event is relevant to determining whether the cash flows are SPPI

Zach

- Why did the IASB consider this project a high priority?
- Why did the IASB not decide to develop an ESG-specific exemption?

Project scope – CLIs and non-recourse

SPPI assessment for CLIs and non-recourse features

Clarification of
- scope of requirements for Contractually Linked Instruments (CLIs)
- meaning of non-recourse features
- how the characteristics of the underlying pool of instruments affect the SPPI assessment for CLIs and financial assets with non-recourse features

Riana

- Why did the IASB decide to also make clarifying amendments to these aspects of the SPPI requirements?

Modifications and effective interest method

Topics	PIR feedback[1]
Modifications of financial assets and financial liabilities	• Challenges in applying the requirements in practice • Some feedback requesting clarity on: - what constitutes a modification of contractual cash flows - when a modification leads to derecognition
Amortised cost measurement and the effective interest method	• Challenges in applying the requirements in practice (ie floating rate) • Some feedback requesting clarity on: - how to reflect conditions attached to the contractual interest rate - how to reflect subsequent changes in estimated future cash flows

IASB response[2]

The IASB decided to add this topic to its research pipeline in July 2022

[1] AP3A–AP3B for the July 2022 IASB meeting

[2] AP3C for the July 2022 IASB meeting

Other topics

- **Equity instruments and other comprehensive income** – mixed views on scope of presentation option and non-recycling
- **Business model assessments** – broad support with some application questions

Zach

- Was the feedback on equity instruments and other comprehensive income aligned with your expectations?

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3. PIR of IFRS 9—Impairment

Questions for stakeholders in Phase 1 of the PIR

A Are there fundamental questions (ie ‘fatal flaws’) on the clarity and suitability of the impairment requirements?

B Are the benefits to users of financial statements significantly lower than expected?

C Are the costs of applying the requirements and auditing and enforcing their application significantly greater than expected?

Impairment requirements—topic areas

General approach	Determining significant increases in credit risk	Measurement of ECLs
Credit-impaired on initial recognition	Simplified approach for trade and lease receivables	Loan commitments and financial guarantees
	Disclosures—credit risk disclosures in IFRS 7	

General approach

Background

- Investors requested information about **changes in credit risk** and the **resulting economic losses**
- Supported distinguishing assets with significant increase in credit risk from those without it
- The impairment model in IFRS 9 therefore require:
  - at least 12-month expected credit losses (ECLs) for all financial assets
  - lifetime ECLs when there is a significant increase in credit risk on a financial instrument

Zach

What type of information would help the IASB assess whether the impairment model achieves the objective of providing useful information about changes in credit risk and timely recognition of ECLs?

Determining significant increases in credit risk

Background

- Initial creditworthiness of the borrower and initial expectations of credit losses are reflected in its pricing and other conditions
- A true economic loss arises when ECLs exceed initial expectations
- Recognising lifetime ECLs after a significant increase in credit risk (SICR) better reflects that economic losses
- IFRS 9 includes simplifications and a practical expedient for assessing SICR for financial instruments that:
  - have low credit risk at the reporting date
  - are more than 30 days past due

Riana

- What are some important principles that underpin the SICR requirements, to be considered when stakeholders provide feedback on this topic?
- What feedback about SICR would be most helpful for the IASB's assessments?

Measurement of ECLs

Background

- IFRS 9 responded to requests for more forward-looking information about credit losses, transparent and timely information about changes in credit risk
- Based on reasonable and supportable information, available without undue cost or effort
- Historical data is always considered to be an important anchor or base but should be adjusted on the basis of current observable data

Spotlight

- Often hear feedback about the challenges of incorporating forward-looking information in ECLs
- Need to distinguish between challenges that relate to:
    a. availability of information or its quality, interaction with relevant regulatory guidelines, the extent of judgement required; and
    b. standard-setting issues—problems with the impairment requirements in IFRS 9 which could be addressed by the IASB or the Interpretations Committee?

Credit-impaired on initial recognition

- Applies to **purchased** and **originated** credit-impaired (POCI) financial assets
- Use **credit-adjusted effective interest rate**
  a. No day 1 loss allowance balance
  b. No day 1 impairment loss recognised
- Allowance balance always represents **cumulative changes** in lifetime ECLs

Background

- The IASB considered but rejected a gross-up approach, whereby an allowance is recognised for initial expected credit losses and is used to gross-up the carrying amount of the POCI
- Although the scope of requirements for credit-impaired assets usually relates to purchased financial assets, in unusual circumstances financial assets could be originated that would be within this scope

Simplified approach for trade receivables, contract assets and lease receivables

Background

- When developing IFRS 9, the IASB considered the costs and complexities for non-financial institutions to calculate 12-month ECLs and track the SICR
- Feedback indicated that most trade receivables without a significant financing component would have a maturity less than one year, so the lifetime ECLs and the 12-month ECLs would be similar

Zach

- What information about the simplified approach is the IASB looking for in this PIR?

Loan commitments and financial guarantee contracts

Issued loan commitments and financial guarantees
(Issuers' perspective)

- Those not measured at FVTPL are in scope of IFRS 9 for impairment
- General approach to ECLs is applied:
  - Generally measure ECLs over contractual period exposed to credit risk
  - Exception for some loan commitments such as revolvers

Collateral and other credit enhancements
(Holders' perspective)

- In measuring ECLs, the estimate of expected cash shortfalls shall reflect the cash flows expected from collateral and other credit enhancements that are part of the contractual terms and are not recognised separately by the entity

Background

- Previously, IAS 37 applied to some loan commitments and financial guarantees. This was the case despite the exposure to credit risk on these instruments being similar to that on loans or other financial instruments and the credit risk being managed in the same way

- The IASB therefore concluded that an entity shall apply the same impairment model to those loan commitments and financial guarantee contracts

Disclosures—IFRS 7 credit risk disclosures

Background

- Improved disclosure requirements for ECLs were included in IFRS 7
- Requiring both qualitative and quantitative information to assist users understand and identify:
  - an entity’s credit risk management practices;
  - the amounts in the financial statements that arise from ECLs; and
  - an entity’s credit risk profile, including significant credit concentrations at the reporting date
- Considering the differences in how entities approach credit risk management, the IASB decided for objective-based disclosures

Zach

- What feedback are you most interested with respect to credit risk disclosures in IFRS 7?
- The IASB frequently hears calls for sensitivity analysis in context of ECLs—what is the role of disclosures when it comes to sensitivity analysis?

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Questions?

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