IFRS® Foundation

Post-implementation review of IFRS 9—Classification and Measurement

Phase 1—identifying matters to be examined

Capital Markets Advisory Committee

Agenda Paper [AP1]

March 2021

Purpose of this session

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- Ask CMAC members to share their views on the application of IFRS 9 *Financial Instruments*, as well as matters that members think the IASB should consider for the Post-implementation Review (PIR) of the classification and measurement requirements in IFRS 9

Questions for CMAC members

See three questions on the next slide

Slides 6–26 provide supporting material
Slides 12–26 provide an overview of the six areas of the classification and measurement requirements, further background information and some detailed outreach questions
We do not expect CMAC members to answer those questions in this meeting, they are provided as support information only
The topics in slides 14, 15, 20, 21 and 23 may be of most interest to CMAC members

Questions for CMAC members

1

- The classification categories and measurement approaches in IFRS 9 are designed to provide users with information about how an entity expects to realise cash flows (by holdings financial assets, selling them, or both)
- Therefore helping users of financial statements understand the nature and uncertainty of future cash flows

Does IFRS 9 provide useful information about how an entity manages financial assets to realise cash flows?

2

- Comparability in financial information assists users in making informed investment decisions
- We are interested in learning about whether the classification and measurement (C&M) requirements are being applied consistently and provided to users on a consistent basis

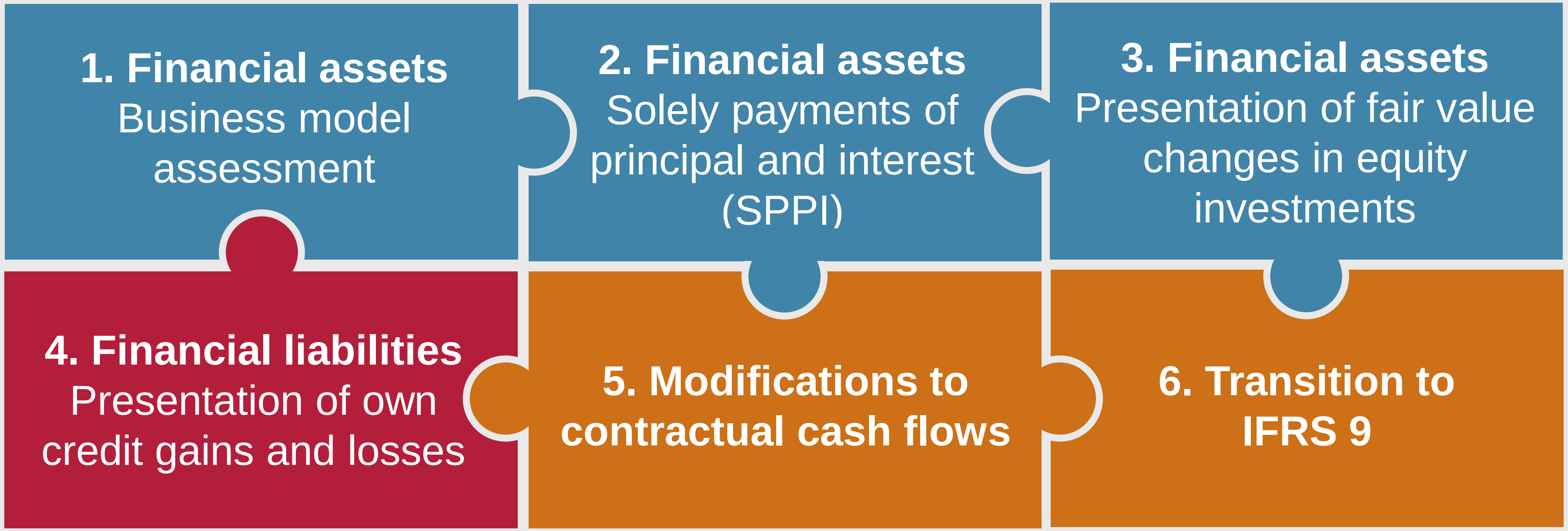
Is C&M information comparable between different entities? Is there information you expected to see which is not being provided?

3

- In the first set of IFRS 9 financial statements (ie 2018 financial statements for most entities), entities were not required to restate comparative information. They were, however, required to provide extensive transition disclosures to explain changes in classification

Did you find the information provided in the first set of IFRS 9 financial statements useful to understand the changes in classification?

Classification and measurement—topic areas



Note

For the purpose of PIR outreach, we will categorise the classification and measurement requirements into these six topic areas

Slides 12–26 provide an overview of the requirements for each of these areas

The topics in slides 14, 15, 20, 21 and 23 may be of most interest to CMAC members

Supporting material

Background

IFRS 9 *Financial Instruments*

- Effective for annual reporting periods beginning on or after 1 January 2018
- Improved and simplified accounting that replaced IAS 39
- First stage of post-implementation review starting now (classification and measurement)

Classification and measurement	A single logical classification approach driven by contractual cash flow characteristics and how the instrument is managed
Impairment	A much needed and strongly supported forward-looking ‘expected loss’ model
Hedge accounting	An improved and widely welcomed model that better aligns accounting with risk management

Classification and measurement

You spoke, we listened

IFRS 9 responded to the many application issues that arose from the IAS 39 classification and measurement requirements and gives investors better information about the amounts, timing and uncertainty of cash flows

Issues with IAS 39	Solutions in IFRS 9
Rule-based classification	Principle-based classification
Complex and difficult to apply	Logical approach based on business model and nature of contractual cash flows
Own credit gains and losses recognised in profit or loss for fair value option (FVO) liabilities	Own credit gains and losses presented in other comprehensive income (OCI) for FVO liabilities
Complicated reclassification rules	Business model-driven reclassification

IASB activities since IFRS 9 was issued

A solid foundation for the PIR

The IASB has put significant efforts into monitoring and supporting the implementation of IFRS 9
The information gathered through all our activities since IFRS 9 was issued provides a solid foundation on which to start the post-implementation review

Here are just some examples of what we have been doing:

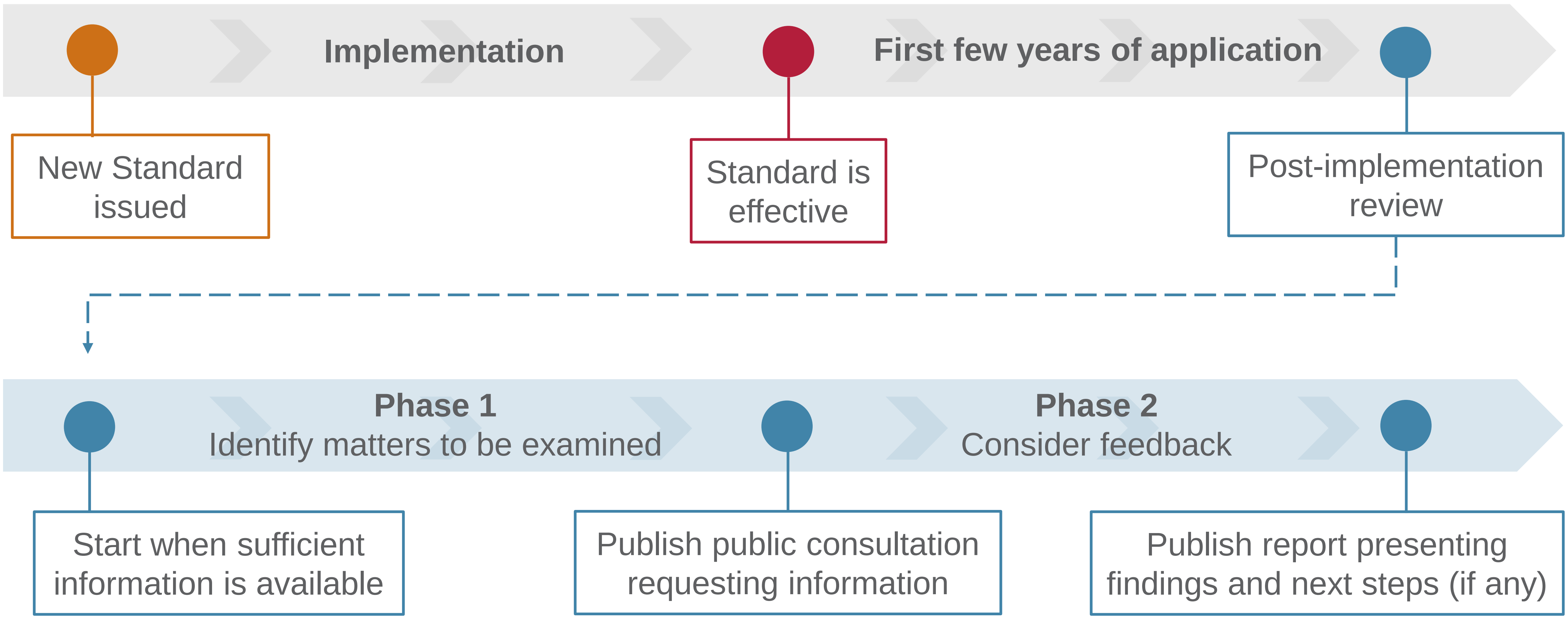
Since IFRS 9 was issued

- Provided educational materials such as articles and webcasts
- Amended IFRS 9 for prepayment features with negative compensation
- Analysed application questions at the IFRS Interpretations Committee
- Established a Transition Resource Group for impairment

Most recently

- Amended IFRS 9 for IBOR Reform and its effect on financial reporting
- Provided educational material on applying IFRS 9 in the light of coronavirus uncertainty

PIR—what is the process?



PIR—where in the process are we?

H2 2020	H1 2021	H2 2021
IASB decided to start PIR of classification and measurement*	Phase 1 outreach and information gathering	Publish consultation document (RFI)

* In H2 2020 the IASB concluded more time was needed for it to have sufficient information to start the PIR of the impairment and hedge accounting requirements

Detailed information and questions to support outreach

1. Financial assets—business model assessment

Classification of debt financial assets		Business model		
		Hold to collect	Hold to collect & sell	Other
Cash flows	SPPI	Amortised cost*	FVOCI*	FVPL
	Other	FVPL	FVPL	FVPL

*Irrevocable option to designate at FVPL if doing so eliminates or significantly reduces an accounting mismatch

- The business model is a matter of fact and not merely an assertion or management's intention for an individual instrument
- Sales information is considered but does not in isolation determine the business model

The business model is:

- typically observed through activities undertaken (eg business plans, manager compensation)
- determined at a level that reflects how financial assets are managed

1. Financial assets—business model assessment

How an entity manages assets to realise contractual cash flows

Background

- The business model assessment aligns the measurement of financial assets with the way the entity manages those assets to realise contractual cash flows (ie from collecting contractual cash flows, selling financial assets or both)
- The business model provides information that is useful in assessing the amounts, timing and uncertainty of the entity's future cash flows
- There are no 'bright lines' between the different business models in IFRS 9, rather an entity needs to consider all relevant evidence available to make the assessment

Outreach questions

- Is it clear how IFRS 9 distinguishes the different ways an entity manages financial assets to realise contractual cash flows?
- Is it clear why the way an entity manages financial assets to realise contractual cash flows leads to measurement at either amortised cost or fair value?

1. Financial assets—business model assessment

Reclassification after initial recognition

Background

- Users of financial statements questioned the usefulness of information about reclassifications in IAS 39 and expressed concern that opportunistic reclassification could be used to manage earnings
- The IASB considered prohibiting reclassification completely, but decided to limit reclassification to changes in business model only. The IASB expected events leading to changes in business model to be rare and significant enough to be demonstrable to external parties
- Reclassification when there is a change in business model ensures that information is provided that is useful to users in predicting likely actual cash flows

Outreach questions

- How frequent and in what circumstances have you observed financial assets being reclassified due to a change in business model (ie a change in the way the entity manages financial assets to realise contractual cash flows)?
- Is the information disclosed about reclassification both useful and sufficient for users to understand the reason for the reclassification and the effect?

2. Financial assets—SPPI

Solely payments of			
Principal	**Interest**		
Fair value at initial recognition	Time value of money	Credit risk	Other basic lending costs & profit

- Only debt financial assets with cash flows that are solely payments of principal and interest (SPPI) are eligible for measurement at amortised cost or FVOCI
- IFRS 9 provides extensive guidance on assessing whether contractual cash flows are SPPI
- For cash flows to be SPPI they must not introduce exposure to risks that are not consistent with a basic lending arrangement
- Often it is apparent whether cash flows are SPPI but sometimes closer analysis is required

2. Financial assets—SPPI

Scope

Background

- Amortised cost is a simple measurement approach for contractual cash flows that are SPPI
- Fair value measurement reflects the amount, timing and uncertainty of more complex cash flows arising from contractual features other than basic lending features
- The SPPI requirement draws a line between contractual cash flows for which amortised cost provides useful information and those for which it does not
- Some contracts might commonly be considered ‘vanilla’ but include features with cash flows that are not SPPI

Outreach questions

- Is the SPPI requirement appropriate to define financial assets for which amortised cost measurement provides useful information?
- Is there sufficient and appropriate application guidance in IFRS 9 for the SPPI requirement to be applied consistently in the light of market developments since IFRS 9 was issued?

2. Financial assets—SPPI

Contractually linked instruments

Background

- In some types of transactions an issuer may prioritise payments to the holders of financial assets using multiple contractually linked instruments (CLIs) that create concentrations of credit risk (tranches)
- IFRS 9 provides guidance on assessing whether each tranche has contractual cash flows that are SPPI
- Some stakeholders have said they find the guidance in IFRS 9 on assessing whether contractually linked instruments are SPPI limited and unclear

Outreach questions

- Is there sufficient application guidance in IFRS 9 to:
  a. determine the scope of financial instruments that are within the scope of the CLI requirements; and
  b. apply the requirements consistently?

3. Financial assets—equity investments

Presentation of fair value changes in equity investments	Most equity investments	Election in specified circumstances
	P&L	OCI

- Equity investments are measured at fair value because they have cash flows that are not SPPI
- The default in IFRS 9 is to recognise changes in fair value in P&L
- In some specific circumstances an entity can irrevocably elect to present fair value changes in OCI (election at initial recognition and on an instrument-by-instrument basis)

- To be eligible the investment must be equity as defined in IAS 32 and not held for trading
- If an entity presents fair value changes in OCI, dividends continue to be recognised in P&L, gains and losses recognised in OCI are not 'recycled' to P&L on sale of the investment, and there is no impairment test

For more information on IFRS 9 and equity investments read our article *here*

3. Financial assets—equity investments

Recognition of fair value changes in P&L

Background

- In the IASB's view, if an equity investment and changes in its value are relevant to an entity's performance, the most useful information about that investment is provided by measuring the investment at fair value through profit or loss
- Recognising fair value changes in P&L reflects the economic reality of the nature, timing and uncertainty of future cash flows
- Some stakeholders continue to express concern that recognising fair value changes in P&L does not reflect the business model of a long-term investor

Outreach questions

- Are the requirements for equity investments clear?
- Do users of financial statements find the information in P&L about changes in fair value of equity investments held by an entity that is a long-term investor useful in understanding the entity's performance?

3. Financial assets—equity investments

Option to present fair value changes in OCI

Background

- The option to present fair value changes in OCI for equity investments was created for unusual cases in which changes in fair value of an equity investment may not be indicative of the entity's performance, for example when the entity holds the investment for strategic reasons (eg to strengthen a business relationship)
- Gains and losses recognised in OCI on such investments are not recycled to P&L—even on sale of the investment—because those gains and losses are not part of the entity's performance
- Some stakeholders suggest the IASB amend IFRS 9 to require recycling of such gains and losses, similar to the AFS category in IAS 39

Outreach questions

- What is the significance and characteristics of the investments affected by the removal of the AFS category for equity investments?
- How has this affected entities' investment decisions (ie nature and type of investment?)
- How prevalent is the use of the FVOCI presentation election?
- How do investors respond to choices made?

4. Financial liabilities—own credit gains and losses

Classification of financial liabilities

1	2 Financial liabilities designated as at FVPL			3
Derivatives and other financial liabilities required at FVPL	**Balance sheet**	**P&L**	**OCI***	All other financial liabilities at amortised cost
	Fair value	Changes in FV except own credit	Changes in FV due to own credit	

*An exception requires recognition in P&L if recognition in OCI would create or enlarge an accounting mismatch

- Financial liability accounting essentially unchanged from IAS 39, except for own credit on financial liabilities designated under the fair value option
- For those financial liabilities gains and losses arising from changes in fair value due to change in own credit risk are presented in OCI

4. Financial liabilities—own credit gains and losses

Presenting own credit gains and losses in OCI

Background

- The fair value of an entity's own debt is affected by changes in the entity's own credit risk. This means when an entity's credit quality declines, the value of its liabilities fall resulting in the recognition of a gain (and vice versa) if the liability is designated as measured at fair value
- When developing IFRS 9, the IASB conducted extensive outreach on how best to address the effects of changes in the fair value of a financial liability caused by changes in own credit risk. Primary feedback from users indicated that effects of changes in a liability's credit risk should not affect P&L unless the liability is held for trading
- IFRS 9 requires changes in own credit to be presented in OCI

Outreach questions

- Is the scope of financial liabilities for which own credit gains or losses are presented in OCI appropriate?

5. Modifications to contractual cash flows

Modifications to contractual cash flows—financial assets and financial liabilities	If derecognition criteria met	If derecognition criteria not met
	Derecognise	Recalculate gross carrying amount and recognise adjustment in P&L

Background

- When finalising the IBOR amendment, the IASB noted inconsistency in the wording used to describe what is a modification for financial assets and financial liabilities
- If different entities consider different factors in assessing whether there has been a modification, this could result in entities applying different accounting treatments to the same situations

Outreach questions

- Are the modification requirements and application guidance capable of being applied consistently?
- Are you aware of any diversity in practice in the application of the modification requirements to financial assets and financial liabilities?

6. Transition to IFRS 9

Classification and measurement

Applied retrospectively to determine opening balances in first set of IFRS 9 financial statements*

Apply IFRS 9 going forward

Date of initial application

* With some transition reliefs and exceptions (see below)

- Business model assessment performed at date of initial application
- SPPI assessment performed based on contractual cash flows at initial recognition. However, relief given for some aspects of the SPPI assessment if retrospective application is impracticable
- Specific requirements and permissions for designating debt financial assets at FVPL, equity investments at FVOCI and financial liabilities at FVPL, and revoking previous designations
- Some other specific requirements and reliefs

6. Transition to IFRS 9

Background

- When developing IFRS 9, the IASB considered the difficulties and associated costs of retrospective application of the classification and measurement requirements
- Whilst most stakeholders agreed that in principle retrospective application provides the best information, many questioned the practicability and noted a need for extensive reliefs
- The IASB considered requiring prospective application, but ultimately decided the best balance was achieved by requiring retrospective application with reliefs to address particular difficulties. The IASB also decided not to require restatement of comparative information, but to instead require extensive transition disclosures

Outreach questions

- Did entities face significant challenges applying classification and measurement retrospectively? Why? How did they overcome those challenges?
- What additional relief could have helped entities without significantly reducing the benefit of retrospective application?
- Did the combination of the relief from restating comparative information and the requirement for extensive transition disclosures achieve an appropriate balance between reducing difficulties and associated costs for entities and providing useful information for users?

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