SAICA DIFFERENCE MAKERS™

19 July 2023

International Accounting Standards Board
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Email: commentletters@ifrs.org

Dear Sir/Madam

SAICA SUBMISSION ON ED/2023/2 – *AMENDMENTS TO THE CLASSIFICATION AND MEASUREMENT OF FINANCIAL INSTRUMENTS*: PROPOSED AMENDMENTS TO IFRS 9 AND IFRS 7

In response to your request for comments on the ED/2023/2 – *Amendments to the Classification and Measurement of Financial Instruments*: Proposed amendments to IFRS 9 – *Financial Instruments* and IFRS 7 – *Financial Instruments: Disclosures*, attached is the comment letter prepared by the South African Institute of Chartered Accountants (SAICA). This comment letter results from deliberations of SAICA's Accounting Practices Committee (APC). The APC comprises members from reporting organisations, regulators, auditors, IFRS specialists, investment analysts and academics.

We thank you for the opportunity to provide comments on this Exposure Draft (ED).

Please do not hesitate to contact us should you wish to discuss any of our comments.

Prof Ahmed Mohammadali-Haji
Chairperson: APC

Mulala Sadiki
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Cc: Bongeka Nodada
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SPECIFIC COMMENTS

Question 1—Derecognition of a financial liability settled through electronic transfer

Paragraph B3.3.8 of the draft amendments to IFRS 9 proposes that, when specified criteria are met, an entity would be permitted to derecognise a financial liability that is settled using an electronic payment system although cash has yet to be delivered by the entity.

Paragraphs BC5–BC38 of the Basis for Conclusions explain the IASB's rationale for this proposal.

Do you agree with this proposal? If you disagree, please explain what aspect of the proposal you disagree with. What would you suggest instead and why?

We generally agree with the International Accounting Standards Board's (IASB) proposals and welcome the fact that the proposed exception in the Exposure Draft (ED) is permitted and not mandatory, hence entities can apply the normal derecognition requirements in paragraph 3.3.1 of IFRS 9 for financial liabilities (i.e. only derecognising the liability when the contractual obligation is extinguished). We have observed that there is some diversity in practice where in certain instances entities apply settlement date accounting and derecognise the financial liability when the electronic cash payment has been received by the payee/creditor. In other instances, some entities may apply derecognition prior to when the electronic cash payment has been received by the creditor.

Whilst we agree with the proposals, we have also noted that there may be some challenges in applying the proposed amendments. In particular, we have noted the following points that we request the IASB to consider for further attention:

General requirements:

We agree with the proposals that settlement date accounting should apply for the recognition and derecognition of financial assets and financial liabilities. However, we recommend that additional guidance be provided relating to a possible contradiction between paragraph B.32 of the implementation guidance accompanying IFRS 9 and paragraph B3.1.2A of the proposed amendments.

More specifically, IFRS 9 IG B.32 states: *"IFRS 9 does not contain any specific requirements about trade date accounting and settlement date accounting in the case of transactions in financial instruments that are classified as financial liabilities"* whilst paragraph B3.1.2A of the proposed amendments outline that when recognising or derecognising a financial liability, an entity shall apply settlement date accounting.

Proposed exception:

Overall, we generally agree with the proposed exception to the derecognition of financial liabilities settled using an electronic payment system. We have also noted a few items for which we recommend that the IASB provide further clarification. These include:

- *Clarification on the definition of electronic payment systems*

We recommend that the IASB provide clarification on the definition of an electronic payment system. Furthermore, we also foresee operational challenges that may arise when applying the proposed exception to each electronic payment system. For example, if an entity operates multiple payment systems there could be instances where the same or similar transactions are treated in a different manner depending on whether an entity applies settlement date accounting or the proposed exception.

- *Potential asymmetry or timing mismatches between the derecognition of financial assets and financial liabilities*

  An entity may elect to apply the proposed exception in paragraph B3.3.8 of the ED to the derecognition of financial liabilities (if the specified criteria are met) whilst settlement date accounting would apply to the derecognition of financial assets. This could result in asymmetrical outcomes to the derecognition of financial assets and financial liabilities which may be particularly challenging for inter-company payables and receivables between entities within the same group of companies. For example, a situation could arise whereby a subsidiary applies the proposed exception in paragraph B3.3.8 and derecognises its inter-company payable to a fellow subsidiary before settlement date. However, the other subsidiary derecognises the corresponding inter-company receivable on settlement date once the cash payment is received.

- *Proposed exception criteria relating to settlement risk*

  Paragraph B3.3.8(c) of the ED outlines that the proposed exception applies if settlement risk associated with the electronic payment system is considered insignificant. We request that the IASB provide clarity around the parties to which the settlement risk relates. More specifically, we request that the IASB clarify if settlement risk also considers third party risks associated with financial institutions and other payment processors (for example, risks associated with clearing and settling the amounts subject to payment and whether settlement risk should include the exposure to credit risk relating to the intermediate payment service provider or not).

- We also have concerns around the auditability and cost versus benefit of implementing the proposed exception. In these scenarios, entities will have to obtain a deeper understanding of all relevant processes and develop accounting policies based on the details of each of the financial institutions' reversal/withdrawal processes to ascertain if they have no ability to withdraw, stop or cancel a payment instruction in accordance with the proposed exception criteria in paragraph B3.3.8(a) of the ED.".

In addition, financial institutions may have different processes and time periods for reversing or withdrawing initiated transactions. This may result in operational challenges in instances where entities make use of several financial institutions to process electronic payments. In these scenarios, entities will have to source the details of each of the financial institutions' reversal/ withdrawal processes to ascertain if they have no ability to withdraw, stop or cancel a payment instruction in accordance with the proposed exception criteria in paragraph B3.3.8(a) of the ED.

It also appears that from a practical perspective, satisfaction of the proposed exception criteria outlined in paragraphs B3.3.8 to B3.3.10 of the ED is a high hurdle and which may only be met very close to or at settlement date in some instances. In such circumstances, it is possible that there would not be a significant difference in applying the general requirements or the proposed exception.

Recommendations

To address some of the points we have raised above, we request the IASB to consider the following amendments:

- Expand paragraph B3.1.2A of the proposed amendments to address what is the definition of settlement date accounting for the creditor.
- Insert a point (d) within the proposed exception criteria in paragraph B3.3.8 of the ED and state that no information has occurred at the reporting date that indicates that points (a), (b) and (c) of the proposed exception criteria have not been met.
- Paragraph B3.3.8 (a) of the proposed amendments accommodate for circumstances where recalling the payment is a usual protective clause, such as in the case of fraud. The proposed insertion can be aligned with paragraph 42C(a) of IFRS 7 dealing with disclosures about continuing involvement in transferred assets.

Question 2—Classification of financial assets—contractual terms that are consistent with a basic lending arrangement

Paragraphs B4.1.8A and B4.1.10A of the draft amendments to IFRS 9 propose how an entity would be required to assess:
(a) interest for the purposes of applying paragraph B4.1.7A; and
(b) contractual terms that change the timing or amount of contractual cash flows for the purposes of applying paragraph B4.1.10.

The draft amendments to paragraphs B4.1.13 and B4.1.14 of IFRS 9 propose additional examples of financial assets that have, or do not have, contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.

Paragraphs BC39–BC72 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

We generally agree with the IASB's proposals included in the proposed amendments and consider that the proposed amendments would provide a much-needed, timely solution to the application of the "solely payments of principal and interest" (SPPI) assessment for financial assets with ESG-linked features.

We do however note the following points that we request the IASB to address or provide further clarity on:

- Paragraph B4.1.8A of the ED states that *"the assessment of interest focuses on what an entity is compensated for rather than how much compensation an entity receives."* We believe that it is difficult to separate the "what for" from the "how much" when undertaking the SPPI assessment and recommend that the IASB re-evaluate this proposed amendment.

- Paragraph B4.1.8A of the ED appears to be contradictory as it outlines that entities should not focus on "how much" but thereafter considers that magnitude is factored into the SPPI assessment i.e. *"a change in contractual cash flows is inconsistent with a basic lending*

arrangement if it is not aligned with the direction and magnitude of the change in basic lending risks or costs." Furthermore, paragraph B4.1.8A appears to be at odds with the de-minimis requirements in paragraph B4.1.18 of IFRS 9 which requires that an entity consider the possible effect (i.e. magnitude) of the contractual cash flow characteristic in each reporting period and cumulatively over the life of the financial asset. One constituent also requested the IASB to provide further clarity or guidance on the proposed amendments and its interaction with the de-minimis test and proposed that both direction and magnitude should still be used to determine whether SPPI is met or not.

- We understand that several industry participants in South Africa are currently applying the de-minimis requirements in paragraph B4.1.18 of IFRS 9 when undertaking the SPPI assessment for financial assets with ESG-linked features. Whilst these requirements have thus far been adequate it is not an appropriate long term, future solution. We request the IASB to provide additional application guidance that is more detailed and considers instruments with more complex ESG-features that can be applied without significant challenges in the future.

- The inclusion of the proposed examples in paragraphs B4.1.13 and B4.1.14 are helpful but also limited as they do not expand on the rationale for the respective conclusions. We recommend that more detail be included in the Basis for Conclusions on IFRS 9 explaining the reasons for how the conclusions in the examples were determined. Some of our constituents also considered that the example in B4.1.14 relating to Instrument I is too restrictive as market factors could be a proxy for a feature specific to the debtor and hence, in such instances, would still meet the SPPI requirements in IFRS 9. We therefore request that the examples be reconsidered or that further clarity be provided on how and why the conclusions in each example are reached.

- In the context of ESG-linked features, it may be difficult to demonstrate that contractual cash flows arising from the occurrence or non-occurrence of a contingent event specific to a debtor, relate to compensation for basic lending risks and costs and are therefore consistent with a basic lending arrangement. More specifically, although the narrative is typically around the environmental component of ESG, we have concerns over the social and governance components of ESG (for example targets linked to the gender/ diversity composition of the Board of an entity) which are increasing in prevalence and how they would link to basic lending risks and costs. We propose that an example be considered for inclusion in the amendments relating to the social and governance components of ESG.

- Paragraph B4.1.10A of the ED requires that for a change in contractual cash flows to be consistent with a basic lending arrangement, the occurrence (or non-occurrence) of the contingent event must be specific to the debtor. However, we envisage scenarios where loan contracts may reference a specific asset rather than be specific to the debtor in which case, per the current amendment, the SPPI requirements would not be met even though the substance of the lending arrangement is the same. Consider an example where a loan is provided to a special purpose vehicle (SPV) which has one operating asset that is subject to the ESG requirement of a reduction in greenhouse gas emissions in the future. Under this scenario, if this contingent event contemplated in the loan agreement is linked to the operating asset, then the SPPI requirements are not met. In contrast, if the loan agreement is linked to the SPV then the SPPI requirements would be met. We request that clarity regarding the application of the criteria be included in the amendments, focusing on circumstances where contingent events are specific to an asset owned by the entity and whether such a contingent event can then by extension be considered specific to the entity.

- Another example would be when a debtor is included in the consolidation scope of a group and the ESG target is fixed at group level or when the debtor is a subsidiary of a parent company and the ESG target is fixed at the parent company level. Therefore, we propose to add in this paragraph that a contingent event is specific to the debtor as long as the target is under the control of the debtor. This reference to the notion of "control" would be consistent with the principles for identifying a contingent settlement provision as outlined in paragraph 25 of IAS 32 – *Financial Instruments: Presentation*. We would also recommend that the IASB clarify the phrase 'specific to the debtor'.

- We also request the IASB to provide further clarity over what is meant by "performance" of an asset. More specifically, whether the IASB means the economic performance of an asset and not for example, the performance of a specified asset towards ESG metrics.

Question 3—Classification of financial assets—financial assets with non-recourse features

The draft amendments to paragraph B4.1.16 of IFRS 9 and the proposed addition of paragraph B4.1.16A enhance the description of the term 'non-recourse'.

Paragraph B4.1.17A of the draft amendments to IFRS 9 provides examples of the factors that an entity may need to consider when assessing the contractual cash flow characteristics of financial assets with non-recourse features.

Paragraphs BC73–BC79 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

We generally agree with the IASB's proposals in the ED. In addition we request that the IASB provide additional illustrative guidance and/or factors to consider when determining when to apply the non-recourse or the contractually-linked instrument (CLI) requirements in IFRS 9.

Question 4—Classification of financial assets—contractually linked instruments

The draft amendments to paragraphs B4.1.20–B4.1.21 of IFRS 9, and the proposed addition of paragraph B4.1.20A, clarify the description of transactions containing multiple contractually linked instruments that are in the scope of paragraphs B4.1.21– B4.1.26 of IFRS 9.

The draft amendments to paragraph B4.1.23 clarify that the reference to instruments in the underlying pool can include financial instruments that are not within the scope of the classification requirements of IFRS 9.

Paragraphs BC80–BC93 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

We generally agree with the IASB's proposals in the ED. We also request that the IASB provide further clarity and/or illustrative guidance on what would qualify as a tranche and what features to consider for the purposes of applying the contractually linked instruments (CLI) requirements in IFRS 9.

A constituent mentioned that paragraph B4.1.20A indicates that the contractual cash flows of the senior debt will be assessed by applying the requirements in paragraphs B4.1.7 – B4.1.19 however there is no mention of the junior debt's application. Further guidance relating to junior debt's application is recommended.

Question 5—Disclosures—investments in equity instruments designated at fair value through other comprehensive income

For investments in equity instruments for which subsequent changes in fair value are presented in other comprehensive income, the Exposure Draft proposes amendments to:

(a) paragraph 11A(c) of IFRS 7 to require disclosure of an aggregate fair value of equity instruments rather than the fair value of each instrument at the end of the reporting period; and

(b) paragraph 11A(f) of IFRS 7 to require an entity to disclose the changes in fair value presented in other comprehensive income during the period.

Paragraphs BC94–BC97 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

We generally agree with the IASB's proposals in the ED and are supportive of the proposals to disclose an aggregate fair value of equity instruments rather than the fair value of each instrument at the end of the reporting period.

Some of our constituents consider that the proposed amendments in paragraph 11A(f) of IFRS 7, to disclose the amount of change that is driven by derecognised "fair value through other comprehensive income" equity instruments separately from the amount that relates to the instruments still held, does not add incremental informational value for users or provide information relating to the total return earned on a particular equity investment and have therefore requested the IASB to reconsider adding this additional disclosure requirement.

Question 6—Disclosures—contractual terms that could change the timing or amount of contractual cash flows

Paragraph 20B of the draft amendments to IFRS 7 proposes disclosure requirements for contractual terms that could change the timing or amount of contractual cash flows on the occurrence (or non-occurrence) of a contingent event. The proposed requirements would apply to each class of financial asset measured at amortised cost or fair value through other comprehensive income and each class of financial liability measured at amortised cost (paragraph 20C).

Paragraphs BC98–BC104 of the Basis for Conclusions explain the IASB's rationale for this proposal.

Do you agree with this proposal? Why or why not? If you disagree, please explain what aspect of the proposal you disagree with. What would you suggest instead and why?

We generally agree with the IASB's proposed amendments but have noted the following points for further consideration by the IASB:

- We recommend that further clarity be provided as to whether the proposed disclosure amendments will be ring-fenced to only ESG-linked contingent features. We are concerned that should the proposed disclosure amendments apply more broadly, this may bring into scope other instruments that do not have ESG-linked features. We do not believe that this was what constituents had indicated in feedback provided during the post-implementation review of IFRS 9's classification and measurement requirements.

- Should the proposed disclosure amendments apply more broadly, this will increase the operational effort for preparers in determining the universe of instruments that have contractual terms that could change the timing or amount of contractual cash flows on the occurrence (or non-occurrence) of a contingent event. Without sufficient specificity or clarification, we are unsure as to what other contractual features would constitute a contingent event that is specific to a debtor and to which the proposed disclosure amendments should apply and we are therefore of the view that this will result in different application and consequently incomparable disclosure provided by entities per industry and per jurisdiction.

- We hence recommend that the IASB specify that the proposed disclosure amendments apply only to those financial assets with ESG-linked features and that a cost/benefit analysis should be undertaken before introducing additional disclosure requirements.

- Paragraph 20C of IFRS 7 indicates that an entity shall consider how much detail to disclose and the appropriate level of aggregation or disaggregation. We recommend that the IASB provide more guidance on what the appropriate level of aggregation would be to enhance comparability and assist entities in their implementation efforts when sourcing the relevant information for these disclosures.

Question 7—Transition

Paragraphs 7.2.47–7.2.49 of the draft amendments to IFRS 9 would require an entity to apply the amendments retrospectively, but not to restate comparative information. The amendments also propose that an entity be required to disclose information about financial assets that changed measurement category as a result of applying these amendments.

Paragraphs BC105–BC107 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

We generally agree with the IASB's proposals in the ED. We recommend that entities be permitted to early adopt the proposed amendments relating to the SPPI assessment for financial

assets with ESG-linked features. We envisage that the transition date for the proposed amendments relating to electronic cash payment transfers would have a longer lead time to allow entities to gather the necessary information in preparation for implementation and hence early adoption for the proposed amendments relating to the SPPI assessment for the finance assets with ESG-linked features is recommended.

It is also unclear how the amendments for electronic cash payments should be implemented in the Statement of Cash Flows. For example, consider a scenario where a transaction meets the criteria under the proposed amendments and would have done so in the prior year but was presented as a payable in the prior year. A question arises as to whether the transaction should be accounted for as a cash flow in the current Statement of Cash Flows or would the prior year closing cash position be adjusted resulting in a restatement of the prior year Statement of Cash Flows.