Accounting Standards Board
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Conseil des normes comptables

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March 28, 2013

International Accounting Standards Board
30 Cannon Street, 1st Floor
London EC4M 6XH
United Kingdom

Dear Sirs:

**Re: Exposure Draft, Classification and Measurement: Limited Amendments to IFRS 9**
**IASB Reference ED 2012/4**

This letter is the response of the Canadian Accounting Standards Board (AcSB) to the Exposure Draft, *Classification and Measurement: Limited Amendments to IFRS 9,* issued in November, 2012.

The AcSB is Canada's national accounting standard setting body, which has adopted a strategy of importing IFRSs into Canada for publicly accountable enterprises. The AcSB consists of members from a variety of backgrounds, including financial statement users, preparers, auditors and academics. Additional information about the AcSB can be found at www.frascanada.ca.

The views expressed in this letter take into account comments from individual members of the AcSB and its staff. However, they do not necessarily represent a common view of the AcSB, its committees or staff. Formal positions of the AcSB are developed only through due process.

The AcSB is very encouraged by the degree to which the proposed amendments to IFRS 9 *Financial Instruments* would achieve convergence with the FASB's February 14, 2013 proposed standard on Recognition and Measurement of Financial Assets and Financial Liabilities. We think that greater consistency might be achieved by converging the application guidance in IFRS 9 with that in the proposed FASB standard.

We agree that income measurement on an amortized cost basis for financial assets should be limited to relatively simple interest-bearing instruments. We also agree that the current requirements of IFRS 9

for classification of financial assets present a number of practical and theoretical challenges that will be addressed, at least in part, by the proposed amendments.

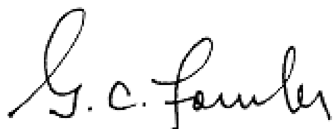
We think that the proposed third business model will improve the consistency of application of the standard and resolve a number of issues with applying the standard. We encourage the IASB to consider converging the application guidance on the distinction between the three categories with that provided in the FASB Exposure Draft.

We do not think the current proposed date for mandatory adoption of IFRS 9 of January 1, 2015 is feasible, especially in light of the fact that, in addition to this exposure draft, the impairment model is incomplete and the hedge accounting portion has not been finalized. We think that at least three years from completion of the standard should be allowed before mandatory adoption of IFRS 9. There are many complexities to the standard that will require at least as much analysis as other new standards expected to be issued in the near future.

We have included in the Appendix our responses to the questions set out in the Exposure Draft.

We would be pleased to elaborate on our comments in more detail if you require. If so, please contact me, Peter Martin, Director, Accounting Standards (+1 416 204-3276 or email peter.martin@cica.ca) or Kate Ward, Principal, Accounting Standards (+1 416 204-3437 or email kate.ward@cica.ca).

Yours truly,



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**APPENDIX**

***Question 1****:*

We agree that a financial instrument with the characteristics of what the exposure draft calls a "modified economic relationship" could have cash flows that meet the criterion of "solely payments of principal and interest". We are concerned that by restricting the change to the relatively narrow fact pattern described there will be continued pressure to interpret how the proposed standard applies to similar products or structures that involve a degree of leverage. We also think that the term "modified economic relationship" is confusing. However, the proposed change is a significant step towards a globally consistent standard. We consider this to be the most important objective.

The proposal does not help entities interpret the nature of either interest or principal. We encourage the IASB to consider incorporating guidance from the FASB Exposure Draft that clarifies the nature of cash flows that are solely payments of principal and interest. Specifically, we think that stakeholders will look to various parts of the proposed FASB standard to resolve issues with applying IFRS, including the implied definition of principal (paragraph 825-10-55-14), the guidance on contingent features (paragraphs 825-10-55-23 through 25) and possibly that on beneficial interests in securitized financial assets (paragraphs 825-10-55-26 and 27), as well as the illustrative examples. We encourage the IASB to incorporate similar guidance into IFRS 9 to promote global consistency.

We note that the proposed benchmarking test for financial assets with a "modified economic relationship" will add complexity to the standard. We think that entities capable of sophisticated interest rate modelling will have an advantage in applying the test, limited only by their willingness to incur what could be fairly significant costs. Others may find the costs of applying the standard prohibitive.

***Question 2:***

We think that the term "modified economic relationship" fails to describe the types of instrument that should be evaluated using the proposed benchmarking test. The word "modify" implies a change to the terms of an instrument subsequent to its issue. The term adds to confusion about the intended application of the draft provisions. We do not think it is necessary to label the types of instruments that have interest features that require evaluation if they are adequately described or if the requirement is stated as a principle. However, we think that any changes to the proposal should be undertaken only if converged with similar changes to the FASB proposal.

We are concerned that the proposal uses terms that are ambiguous or imply a specific range of probabilities. Many stakeholders have commented that they are uncertain how to interpret phrases such as "more than insignificant leverage" (paragraph B4.1.9). Similarly, stakeholders are uncertain whether the proposed test is quantitative or qualitative. In addition, we are uncertain whether to assess cash flows on an undiscounted basis, in terms of effective interest rate, or on a net present value basis,

and, if so, discounted using which interest rate. We agree that professional judgement should be exercised in determining the significance of the features of any item. However, we think that the proposed test will be difficult to interpret and apply with reasonable consistency without additional guidance or examples.

Our comments above notwithstanding and despite the increased complexity and resultant costs, we think the idea of a benchmark test is a workable approach to determining whether a rate-setting mechanism disqualifies a financial asset from measurement at amortized cost or fair value through other comprehensive income.

***Question 3:***

We think the proposed amendment will clarify application of the contractual cash flow characteristics criterion to financial assets with an interest rate reset mismatch. We think that the proposal is a practical accommodation for a specific fact pattern. We are concerned that it does not systematically result in “more appropriate identification of financial assets with contractual cash flows that should be considered solely payments of principal and interest”. A rate reset mismatch is only one of several possible features that would not necessarily cause cash flows to differ significantly from those of a benchmark instrument. Although the proposed standard is clearer in the scope of instruments to which amortized cost income measurement may apply, we think the boards may be challenged to increase the scope of the exception even further.

We also think that the proposed amendment increases complexity and adds cost. However, we think that the benefits of a standard that is converged globally outweigh the additional complexity.

***Question 4***

We agree that there will be many practical benefits from measuring certain financial assets at fair value for balance sheet purposes, capturing unrealized gains and losses in other comprehensive income and recognizing profit or loss on an amortized cost basis. Members of the AcSB’s User Advisory Council think that this model will help them evaluate performance against normalized earnings. They also think that fair value measurement in the balance sheet is a better indicator of asset quality and future earnings potential than disclosure of fair value information in the notes to the financial statements.

We think that the category is a practical solution to the challenge of reporting the liquidity portfolios of banks in a logical way. Representatives of the Canadian insurance industry agree that the proposed category will be helpful for investments in debt securities backing policy liabilities. We also think that the category is a practical solution for entities outside the financial services industry that hold investments but do not actively trade them.

***Question 5:***

We are not convinced that a business model in which financial assets are held both to collect contractual cash flows and for sale is sufficiently distinct to avoid application problems.

We reiterate that words such as “infrequent” and “significant” or “insignificant” are difficult to interpret and apply consistently. We are particularly concerned that the statement in paragraph B4.1.3 “Sales that occur for other reasons may also be consistent with a business model whose objective is to hold financial assets in order to collect contractual cash flows if such sales are infrequent (even if significant) or insignificant both individually and in aggregate (even if frequent)” will be difficult to apply. We think that additional guidance similar to that provided in the FASB exposure draft should be included in IFRS 9, including that on sales resulting from managing concentrations of credit risk (paragraph 825-10-55-31), sales resulting from changes other than managing credit risk (paragraph 825-10-55-32) and changes in the business model (paragraphs 825-10-55-86 and 87).

Stakeholders are uncertain how to define portfolios for purposes of applying the business model test. Many have also expressed uncertainty about how to handle transfers of assets between portfolios and how to classify assets that are purchased but are not immediately allocated to a portfolio.

Further, in attempting to clarify the boundary between instruments qualifying for amortized cost treatment and those requiring fair value through profit or loss accounting, the addition of a third category in the proposed amendments will create a second threshold adding to the complexity of the standard and, in all likelihood, preparer costs.

***Question 6:***

The AcSB agrees that the existing fair value option in IFRS 9 should be extended to financial assets that would otherwise be mandatorily measured at fair value through OCI.

The AcSB also thinks that an entity should be able to designate a financial asset that would qualify for amortized cost treatment as measured at fair value through other comprehensive income if doing so mitigates an accounting mismatch.

***Question 7:***

The AcSB agrees that the ability to adopt the 2009 version of IFRS 9 should be discontinued. Entities have had sufficient time to apply that version of the standard, if desired.

We think that entities should be able to apply the hedge accounting chapter separately from other material in IFRS 9, when it becomes available, because it will address significant hedging issues that extend beyond financial instruments.

***Question 8:***

The AcSB agrees.

***Question 9:***

The AcSB is not aware of any considerations unique to first-time adopters.

***Convergence with US GAAP***

We reiterate that convergence with US GAAP is critically important. We are encouraged that this proposal is much closer to the FASB's latest proposal and hope that the boards will work together to resolve remaining differences. We also think that entities will tend to apply the more extensive implementation guidance in the FASB standard unless IFRS 9 clearly indicates that it is inappropriate to do so. We encourage the IASB to adopt more extensive guidance directly.

***Effective date and transition***

We think that the January 1, 2015 mandatory effective date for adoption of IFRS 9 is unrealistic. In our review of IFRS adoption in Canada, many stakeholders reported that the extended lead-time prior to transition was a significant factor in ensuring a smooth transition. To implement IFRS 9 for the calendar year beginning January 1, 2015, a North American entity will need to have determined how its activities translate into the business models required by the standard and developed and tested requisite systems changes in time to prepare a balance sheet at January 1, 2014 (2013 for companies that provide two comparative years of financial results). As noted above, stakeholders do not think that the proposed measurement categories are sufficiently distinct to permit straightforward implementation. There are concerns that the application guidance is unclear, ambiguous or incomplete. As set out in our January 31, 2011 response to the Request for Views on *Effective Dates and Transition Methods*, we think that at least two years is necessary to prepare for any standard that requires potential revisions to recognition or measurement of financial statement items. At least a complete year is necessary to assess the requirements, determine how they apply and develop any accounting policy changes appropriate to ensure consistent application. A second year is required to modify information systems, apply the changes, test them before live application and put in place the necessary internal controls and systems for reporting thereon. Those steps are absolutely not achievable in time for application on January 1, 2015.

We note that the Board has consistently indicated that the transition period for the new standard on *Revenue from Contracts with Customers* will be three years post publication. We think that accounting for financial instruments is at least as complex and, for financial institutions, as fundamental as revenue. We recommend that the mandatory effective date for IFRS 9 be extended to allow at least three years from the date it is completed.