Canadian Accounting Standards Board
277 Wellington Street West,
Toronto, ON Canada M5V 3H2
T. 416 977.3222 F. 416 204.3412
www.frascanada.ca

January 27, 2022

Submitted electronically via www.ifrs.org

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

Dear IASB members,

Re: Post-implementation Review – IFRS 9 *Financial Instruments* – Classification and Measurement (RFI/2021/9)

This letter is the response of the Canadian Accounting Standards Board (AcSB) to the International Accounting Standards Board's (IASB) Request for Information, "Post-Implementation Review – IFRS 9 *Financial Instruments* – Classification and Measurement" issued in September 2021.

Our process

As part of our due process for this Exposure Draft, we consulted with over 50 stakeholders across Canada, including discussions with our User Advisory Committee, IFRS® Discussion Group and Insurance Transition Resource Group. We took the results of these discussions into account when developing this letter. We note that our discussion with the Insurance Transition Resource Group and the insurance industry in general, was in the context of their current implementation of IFRS 9 *Financial Instruments* and IFRS 17 *Insurance Contracts*, whereas other stakeholders with whom we spoke implemented IFRS 9 *Financial Instruments* effective January 1, 2018.

Our view

The AcSB continues to support post-implementation reviews and welcomes the opportunity to comment on the post-implementation review of the classification and measurement requirements of IFRS 9. We think that conducting a post-implementation review of an IFRS Standard is important to fully understand whether a standard, or in this case, parts of a standard, are performing as intended in practice and whether the information provided to users of financial statements is decision useful. We also agree with the IASB's decision to divide its project on IFRS 9 into three stages as we think this will permit the Board to respond to concerns related to the classification and measurement of financial instruments on a more expedited basis.

Overall, we think that the classification and measurement requirements in IFRS 9 enable an entity to align the measurement of financial assets with the cash flow characteristics of the instrument and how the entity expects to manage them. We also think that these requirements result in an entity providing useful information to the users of financial statements about the amount, timing and uncertainty of future cash flows.

However, several stakeholders we consulted questioned whether the principles of IFRS 9 are sufficiently flexible such that they may be applied to increasingly complex financial instruments and still provide relevant and meaningful information to users of financial statements. We think the IASB should review how the contractual cash flow assessment associated with financial assets and the effective interest rate method apply to instruments with variable features or ESG targets. As basic lending arrangements continue to evolve in an increasingly ESG-focused economy, we encourage the IASB to consider if applying the current SPPI criterion will result in an accounting outcome that faithfully represents the underlying terms of the lending arrangements.

Our responses to your questions

The Appendix to this letter responds to the questions posed in the **Request for Information** and expands on the points raised above.

We would be pleased to elaborate on our comments in more detail if you require. If so, please contact me or, alternatively, Katharine Christopoulos, Director, Accounting Standards (+1 416 204-3270 or email kchristopoulos@acsbcanada.ca), or Jamie Goodman, Principal, Accounting Standards (+1 416 204-3294 or email jgoodman@acsbcanada.ca).

Yours truly,

Linda F. Mezon-Hutter, FCPA, FCA, CPA (MI), CGMA
Chair, Canadian Accounting Standards Board

lmezon@acsbcanada.ca
+1 416 204-3490

Our standards

We have adopted IFRS® Standards as issued by the IASB for publicly accountable enterprises. Canadian securities legislation permits the use of U.S. GAAP in place of IFRS Standards in certain circumstances. We support a shared goal among global standard setters of high-quality accounting standards that result in comparable financial reporting outcomes regardless of the GAAP framework applied.

We developed separate sets of accounting standards for private enterprises, not-for-profit organizations and pension plans. Pension plans are required to use the applicable set of standards. Private enterprises and not-for-profit organizations can elect to apply either the set of standards developed for them, or IFRS Standards as applied by publicly accountable enterprises.

Our role vis-à-vis IFRS Standards

Our responsibility to establish Canadian GAAP necessitates an endorsement process for IFRS Standards. We evaluate and rely on the integrity of the IASB's due process as a whole, and monitor its application in practice. In addition, we perform our own due process activities for each new or amended IFRS Standard to ensure that the standard is appropriate for application in Canada. We reach out to Canadians on the IASB's proposals to understand and consider their views before deciding whether to endorse a final IFRS Standard. A final standard is available for use in Canada only after we have endorsed it as Canadian GAAP.

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.

1. Overall, we think that the classification and measurement requirements in IFRS 9 enable an entity to align the measurement of financial assets with the cash flow characteristics of the instrument and how the entity expects to manage them. We also think that these requirements result in an entity providing useful information to the users of financial statements about the amount, timing and uncertainty of future cash flows. During our outreach, we heard from preparers and users that they have experienced a few challenges with the classification and measurement requirements in IFRS 9, which we have discussed in more detail in our responses to questions 2–9 below.

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 how 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).

2. Overall, we think that the business model assessment is working as the Board intended. Most of the preparers we consulted commented that they understand the distinction between the different business models in IFRS 9, and how to classify financial assets based on how they are managed.

3. The financial statement users we consulted were supportive of measuring financial assets at amortized cost when an entity's business model is to collect a predictable pattern of contractual cash flows. Overall, they think that the measurement of these assets at amortized cost is most useful because it produces information that can be used to predict the likely actual cash flows for the instrument.

4. During our outreach, we heard that the reclassification of financial assets is very rare because it is only permitted when there is a change in an entity's business model. Such changes are very infrequent and result from significant external or internal changes. We think that the guidance in IFRS 9 is sufficient for entities to determine when a reclassification is required. We also think that the requirements in paragraph 4.4.1 are working as intended to discourage opportunistic reclassifications of financial assets.

Investment entities

5. During our outreach discussions, preparers of financial statements for investment entities stated that fair value information is most relevant to the users of their financial statements. For many liabilities, an entity may irrevocably designate a financial liability to be measured at fair value through profit and loss if it satisfies the criteria in IFRS 9 par. 4.2.2:

   a. it eliminates or significantly reduces an accounting mismatch; or

   b. a group of financial liabilities or financial assets and financial liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided on that basis to the entity's key management personnel.

6. Paragraph 4.1.5 permits a financial asset to be irrevocably designated at fair value through profit or loss if it eliminates or significantly reduces an accounting mismatch which corresponds to paragraph 4.2.2(a). There is no election for financial assets which corresponds to paragraph 4.2.2(b). If an entity's financial assets do not satisfy the accounting mismatch criterion in paragraph 4.1.5 while its financial liabilities satisfy either of the criteria in paragraph 4.2.2, the accounting bases will be misaligned resulting in net income that does not reflect the overall performance of the entity.

7. We understand that this asymmetry was intentional on the basis that financial assets that are managed and whose performance is evaluated on a fair value basis are not held to collect contractual cash flows; therefore, they are required to be measured at fair value through profit and loss, rendering an eligibility condition such as in paragraph 4.2.2(b) irrelevant. However, we recommend the Board reconsider including in paragraph 4.1.5 a condition comparable to paragraph 4.2.2(b); this will enable investment entities to evaluate their performance using the fair value of their financial assets and financial liabilities as a whole and minimize the use of non-GAAP measures.

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).

8. Overall, we think the cash flow characteristics assessment is working as the Board intended for financial assets which have relatively basic terms. However, some stakeholders commented that there are challenges with assessing the cash flow characteristics of more complex financial assets, particularly those with variable features or ESG type targets. In these cases, stakeholders thought that it can be challenging to determine whether the contractual terms of the asset give rise to cash flows that are solely payments of principal and interest. Therefore, we encourage the IASB to consider providing examples to illustrate how the requirements in paragraph 4.1.2(b) would be applied to more complex financial assets.

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).

9. We think that the option to present fair value changes on investments in equity instruments in OCI is working as the Board intended. Based on our outreach activities, we understand that most Canadian entities applying IFRS do not have financial assets classified as fair value though OCI. However, we also heard during our outreach that preparers generally understand when this election is available to them, and how to apply it.

10. The financial statement users we consulted commented that they normally exclude OCI from their financial analysis and calculations of key financial ratios, including Earnings Per Share. Therefore, they recommend that changes in the fair value of equity instruments should be presented in profit or loss whenever possible. For entities that measure equity instruments at fair value through OCI, they recommend that realized gains and losses should be recycled through profit or loss. Overall, they thought that including realized gains and losses in the entity's reported profit or loss makes them more transparent. It also holds management to account for the investment decision given that net income is an important measure of performance of an entity.

11. Notwithstanding the users' concerns with presenting amounts in OCI, we think that there are some challenges with recycling realized gains and losses through profit or loss. Recycling realized gains and losses through profit or loss may require entities to assess such equity instruments for impairment. This assessment created significant application problems for entities applying IAS 39 and reimposing this requirement contradicts the Board's intention to simplify the classification and measurement requirements for financial assets. Therefore, we recommend that the IASB consider feedback received

from stakeholders broadly when assessing the cost and benefits of reintroducing the recycling of gains and losses from OCI to profit or loss.

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.

12. During our outreach, we heard from practitioners, financial statement preparers and users that the requirement for an entity to present the effects of own credit in OCI is working as the Board intended and the population of instruments captured by the requirements is appropriate.
13. We have not identified any other financial liability-specific matters for the Board to consider.

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.

14. During our outreach we heard that there is diversity in practice regarding the application of paragraph 5.4.3 for the modification of cash flows for financial assets. Some stakeholders we consulted highlighted that there is a lack of guidance in paragraph 5.4.3 to determine whether the renegotiated contractual cash flows would be substantially modified and therefore result in the derecognition of the financial asset. These stakeholders shared that in practice, some entities refer to the guidance in paragraph B3.3.6 and the associated 10 per cent test to determine whether the modification to the financial asset's cash flows are

substantive and therefore require derecognition of the instrument. Alternatively, we heard that other stakeholders perform a qualitative assessment to determine whether the modification of the financial asset is substantive. Therefore, we encourage the IASB to clarify or explicitly define when the modification of cash flows associated with the renegotiation of financial assets would qualify as a modification that would require the derecognition of that asset.

Question 7—Amortized 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 'catch-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).

15. Overall, for financial instruments with clearly identifiable cash flows of principal and interest, we think that the effective interest method is working as the Board intended and can be applied consistently. However, this is not necessarily the case for more complex financial instruments, including those with non-standard or variable features, such as ESG targets.

16. In September 2021, our IFRS Discussion Group discussed whether the guidance on floating rate financial instruments in paragraphs B5.4.5 and B5.4.6 of IFRS 9 apply to changes in cash flows resulting from ESG features, assuming those features are not embedded in a derivative that is required to be separated. During those discussions, two views were seen as having merit, dependent on the fact and circumstances of the entity:

    a. View 1: The guidance on floating rate financial instruments in paragraph B5.4.5 is not applicable because the changes in the interest payments due to ESG features do not reflect changes in market rates of interest; therefore, issuers should follow the guidance in paragraph B5.4.6 and adjust the amortized cost of the loan for changes in estimated interest payments.

    b. View 2: B5.4.5 is applicable due to IFRS 9 not defining "floating rate" nor including guidance as to how "market rates of interest" should be interpreted. Under this view, changes in estimated interest payments due to ESG features would adjust the effective interest rate.

17. We think the Board should consider issuing guidance for applying the effective interest method to more complex financial instruments. This guidance could minimize potential application inconsistencies arising from interpretational differences, similar to the one described in the previous paragraph.

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?

18. Most of the preparers and practitioners that we consulted agreed that the classification and measurement transition requirements in IFRS 9 worked as the Board intended and commented that they were able to apply the requirements without significant challenges.

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?**

19. We have not identified additional matters we think the Board should examine as part of this post-implementation review or vis-à-vis future standard-setting projects.