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Mr Andreas Barckow
Chairman
International Accounting Standards Board
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By e-mail only - commentletters@ifrs.org

5 July 2023

Re: Exposure Draft ED/2023/2 – Amendments to the Classification and Measurement of Financial Instruments Proposed amendments to IFRS 9 and IFRS 7

Dear Mr Barckow,

On behalf of RSM International Limited, a worldwide network of independent audit, tax and consulting firms, we are pleased to comment on the IASB's Exposure Draft ED/2023/2 – Amendments to the Classification and Measurement of Financial Instruments Proposed amendments to IFRS 9 and IFRS 7 ('the ED').

We welcome the IASB's Exposure Draft with the aim of clarifying the classification and measurement of financial instruments. We are supportive of the proposed amendments and additional disclosures in both IFRS 9 and IFRS 7. However, we believe the following points need to be reconsidered by the Board:

1) Derecognition of a financial liability settled through electronic transfer

Whilst we agree with the IASB addressing the issue of derecognition of a financial liability settled through electronic transfer, we are concerned that the proposed amendments do not provide sufficient clarity to preparers and users of financial statements.

We believe that the current drafting of the proposed amendments does not consider the number of differing electronic payment systems in place globally. We are concerned that some of the proposed amendments in paragraph B3.3.8 do not provide sufficient clarity to enable the proposed amendments to be applied consistently by entities, in particular the use of the term 'standard administrative process' without clearly defining this term. As noted above, there are numerous electronic payment systems globally, all with differing administrative processes, which would each need to be understood by entities, to consistently apply the proposed amendments, and by financial statement users to understand derecognition of financial liabilities.

Furthermore, we are concerned with the phrase 'time between initiating a payment instruction and the cash being delivered is short' without providing a clear definition of 'short' in paragraph B3.3.9. There will be differing timescales between initiating an electronic payment and the cash being delivered, depending on which electronic payment system an entity uses. We believe that the use of the phrase 'short' without clearly defining it will result in inconsistent application of the requirements leading to diversity in practice.

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To address our concerns, we believe the date an electronic payment is initiated should be used as the date for derecognition of a financial liability, providing that B3.3.8(a) and (b) have been met and the entity has the ability to deliver the cash on settlement date (i.e. settlement risk is insignificant (B3.3.8(c)). This would ensure that the amendments are applied consistently by entities, irrespective of the electronic payment system used by the entity. Furthermore, this would ensure that the application of the requirements is not subjective and is clearly understood by both financial statement preparers and users.

We also believe it would be beneficial for the IASB to provide clarity on how payment instructions initiated, without derecognition of the liability due to settlement risk, should be accounted. In particular, it would be beneficial for entities to have guidance on whether such transactions should be treated as 'cash in transit' and how an entity should recognise such amounts in both the statement of financial position and cash flow statement.

2) Classification of financial assets – contractual terms that are consistent with a basic lending arrangement

We welcome the proposed amendment in B4.1.10A providing guidance on whether specified changes in cash flows following the occurrence (or non-occurrence) of a contingent event would give rise to cash flows that are solely principal and interest on the principal outstanding.

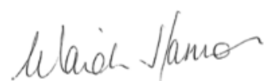
However, we urge the IASB to amend the definition of a derivative in IFRS 9 Appendix 1 to provide clarity on whether contracts with non-financial variables which are specific to a party to a contract are within the scope of the definition of derivatives.

We believe that this amendment is necessary to ensure that the requirements of IFRS 9 are applied consistently by entities to determine whether a contract contains a derivative to reduce the diversity in practice. With the increase in the prevalence of ESG-linked financial instruments, this clarity will ensure that such features are consistently accounted for by entities by eliminating the accounting policy choice currently applied to determine whether a contract does or does not contain a derivative where the contract contains a non-financial variable specific to a party in the contract.

Our comments and detailed responses to the questions set out in the Invitation to Comment section of the ED are detailed hereafter.

We would be pleased to respond to any questions the Board of its staff may have about any of our response. If you have any questions or comments, please do not hesitate to contact Gary Stevenson (+852 2583 1220) or me (+44 (0)207 601 1842).

Yours faithfully,



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APPENDIX

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 welcome the proposed changes to IFRS 9 *Financial Instruments* in response to the requests received by the IFRS Interpretations Committee and their tentative agenda decision to provide guidance on how to apply the requirements of IFRS 9 *Financial Instruments* to electronic payment systems. We believe that clarity is required on derecognition of financial liabilities settled using an electronic payment system due to the increased prevalence of electronic payments across the globe.

We agree with the IASB's proposals to allow a financial liability to be de-recognised before the settlement date if specified criteria are met. We agree with the criteria in B3.3.8(a), allowing an entity to derecognise a liability if the payment instruction has been initiated and the entity has not ability to withdraw, stop or cancel the payment instruction.

We agree with the criteria in B3.3.3(c), requiring that settlement risk associated with the electronic payment is insignificant. We also agree with the last sentence of paragraph B3.3.9, clarifying that settlement risk is not insignificant if the completion of the payment instruction is subject to the entity's ability to deliver cash on the settlement date. We believe that this clarification is necessary, as electronic payments are often initiated for a future date and reliant on the entity having sufficient funds on that future date to honour the electronic payment instruction.

We are concerned that the remaining requirements in paragraph B3.3.8 do not provide sufficient clarity to enable the proposed amendments to be applied consistently by entities. The paragraph B3.3.9 uses the term 'standard administrative process' without clearly defining this term. We are concerned that without a definition, the proposed amendments may be applied inconsistently. Furthermore, the proposals do not take into account the numerous electronic payment systems used globally, with each electronic payment system having a different process. In addition, paragraph B3.3.9, includes the phrase 'time between initiating a payment instruction and the cash being delivered is short' without providing a clear definition of 'short'. We are concerned that the differing electronic payment systems and their associated processes will each have different timescales between initiating an electronic payment and the cash being delivered which will lead to the term 'short' being applied by entities inconsistently resulting in diversity in practice on the application of these requirements.

In our view, the use of the date that the electronic payment is initiated, as the date for derecognition of a financial liability, providing that B3.3.8(a) and (b) have been met and the entity has the ability to deliver the cash on settlement date (i.e. settlement risk is insignificant (B3.3.8(c)), would ensure that the amendments are applied consistently by entities, irrespective of the electronic payment system used by the entity. Furthermore, this would ensure that the application of the requirement is not subjective or open to interpretation by entities.

Furthermore, where a payment instruction has been initiated but the liability has not been derecognised due to settlement risk associated with completion of payment instruction being subject to the entity's ability to deliver cash on settlement date, we believe that the IASB should provide clarity on how such transactions should be accounted, in particular whether such transactions should be treated as 'cash in transit' and how an entity should recognise such amounts in both the statement of financial position and cash flow statement. We are concerned that without such guidance, there will be diversity in practice accounting for electronic payments in transit that do not meet the criteria for the liability to be derecognised.

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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 welcome the proposed amendment in B4.1.10A providing guidance on whether specified changes in cash flows following the occurrence (or non-occurrence) of a contingent event would give rise to cash flows that are solely principal and interest on the principal outstanding. We believe that this amendment is necessary to provide clarity on accounting for ESG-linked financial instruments, as well as other types of financial instruments with contingent events that would give rise to changes in cash flows.

We agree that for such contingent cash flows to be consistent with a basic lending arrangement, they must be specific to the debtor.

Paragraph BC67 of the ED states:

> "*the IASB acknowledged that requiring a contingent event to be 'specific to the debtor' has similarities to the definition of a derivative in IFRS 9, which refers to a 'non-financial variable', that is 'not specific to a party to the contract' ".*

However, whilst there are similarities to the definition of a derivative, we urge the IASB to provide clarity on whether contracts with non-financial variables which are specific to a party to a contract are within the scope of the definition of derivatives.

The reference to a '*non-financial variable'* that is *'not specific to a party to the contract*' within the definition of a derivative was first introduced by IFRS 4. In 2007, the IASB proposed amending the definition of a derivative in IAS 39 to remove the phrase '*provided in the case of a non-financial variable that the variable is not specific to a party to the contract'.* In the Basis for Conclusions for this proposed amendment, the IASB observed that this phrase was introduced when IFRS 4 was issued '*to exclude from the scope of IAS 39 contracts within the scope of IFRS* 4'. Following feedback on the exposure draft, the IASB decided not to proceed with the amendment and would consider the issue in a future project. However, this issue has not been subsequently considered by the IASB and the definition of a derivative in IFRS 9 was carried forward from IAS 39.

Currently, GAAP is interpreting the definition of a derivative as an accounting policy choice, in terms of whether the reference to a '*non-financial variable'* that is *'not specific to a party to the contract*' within the definition of a derivative only applies to insurance contracts or all contracts. In practice, both views are considered acceptable. However, this results in diversity in practice in the application of the definition of a derivative, which could be eliminated with the clarification of whether the reference only applies to insurance contracts or not.

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The accounting policy choices applied in practice in relation to this reference also include whether measures taken from or derived from an entity's financial statements are non-financial or financial variables.

We believe that in light of the proposed amendments to IFRS 9 in this ED, the IASB should provide clarity on:

- whether the reference to non-financial variables not specific to a party in the contract is intended to apply to only insurance contracts or all contracts; and
- whether measures taken from or derived from an entity's financial statements are non-financial or financial variables.

We believe that such clarity to the definition of a derivative in IFRS 9 is necessary to ensure that the requirements of IFRS 9 are applied consistently, thus reducing diversity in practice and increasing comparability. With the increase in the prevalence of ESG-linked financial instruments, this clarity will ensure that such features are consistently accounted for by entities.

The exclusion of insurance contracts only from the definition of a derivative is consistent with the proposed amendment to B4.1.10A. Furthermore, the exclusion of insurance contracts only from the IFRS 9 definition of a derivative as a '*non-financial variable'* that is '*not specific to a party in the contract*', is consistent with current application guidance in IFRS 9 IG A.2 Option to put a non-financial asset and IFRS 9 IG B.7 Definition of a derivative: foreign currency contract based on sales volume, both of which conclude that the arrangements meet the definition of a derivative.

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 agree with the proposed amendments to paragraph B4.1.16 and the addition of paragraph B4.1.16A. We believe that these amendments provide clarity on accounting for financial assets with recourse features.

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 agree with the amendments to paragraphs B4.1.20 to B4.1.21 of IFRS 9 and the addition of paragraph B4.1.120A, clarifying the description of transactions containing multiple contractually linked

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instruments. Furthermore, we agree with the proposed amendments to clarify that the reference to instruments in the underlying pool can include financial instruments which are not within the scope of IFRS 9 classification requirements.

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 welcome the amendments to paragraph 11A(c) and 11A(f) of IFRS 7.

We believe that these disclosures will provide useful information to financial statement users by separately disclosing changes in fair value of investments between those derecognised during the reporting period and those still held at the end of the reporting period.

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 agree with the proposed additional disclosures in paragraph 20B of IFRS which will help financial statement users to understand the effect of contractual terms that could change the timing or amount, or contractual cash flows based on the occurrence or non-occurrence of an event specific to the debtor. We believe that these disclosures will provide useful information to users of financial statements to understand how the contingent event may impact on future cash flows.

Furthermore, we agree with additional paragraph 20C in IFRS 7, requiring the disclosure of the information in IFRS 7 20B by class of asset measures at amortised cost or fair value through other comprehensive income and for each class of financial liabilities measured at amortised cost. However, we believe that the final sentence of IFRS 7 20C should be removed as this will result in diversity in practice and lack of comparability.

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.

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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 agree with the transition requirements for the amendments to IFRS 9 and that an entity should disclose information about financial assets that changed measurement category as a result of applying the amendments to IFRS 9. Furthermore, we agree that restatement should not be required when the amendments are applied but permitted if hindsight is not needed for any restatement.

Furthermore, we agree that the proposed amendments to IFRS 7 should be applied at the same time an entity applies the amendments to IFRS 9.

We have no other comments on the ED.

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