IFRS Accounting

# Staff paper

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**IASB® meeting**

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| Date | **February 2024** |
| Project | **Amendments to the Classification and Measurement of Financial Instruments** |
| Topic | **Feedback analysis – Disclosures – contractual cash flows** |
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## Purpose of this paper

1. This paper addresses feedback received on Question 6 of the Exposure Draft *Amendments to the Classification and Measurement of Financial Instruments* (ED) regarding the disclosure of contractual terms that change the timing or amount of contractual cash flows. The paper asks for the IASB's approval of staff recommendations in response to the feedback received.

2. This paper is structured as follows:

   (a) summary of staff recommendations and question for the IASB;

   (b) proposals in the ED;

   (c) feedback on proposals; and

   (d) staff analysis and recommendations.

## Summary of staff recommendations

3. The staff recommend finalising the proposed disclosure requirements in paragraphs 20B and 20C of the ED, subject to:

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(a) referring to contractual terms that could change the amount of contractual cash flows based on a contingent event that is not directly related to a change in basic lending risks or costs (for example, the time value of money or credit risk) and including an example of a contractual term to which this disclosure requirement would apply; and

(b) not requiring an explicit disclosure of the range of possible adjustments but giving this as an example of the quantitative information about the adjustments to contractual cash flows that an entity should disclose.

| Question for the IASB |
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| Does the IASB agree with the staff recommendations in paragraph 3? |

## Proposals in the ED

4. The IASB proposed in paragraph 20B of the ED to require entities to disclose the following for contractual terms that could change the timing or amount of contractual cash flows on the occurrence (or non-occurrence) of a contingent event that is specific to the debtor:

   (a) a qualitative description of the nature of the contingent event;

   (b) quantitative information about the range of changes to contractual; and

   (c) cash flows that could result from those contractual terms.

5. The IASB proposed in paragraph 20C of the ED that an entity shall disclose the information required by paragraph 20B of the ED separately for each class of financial assets measured at amortised cost or fair value through other comprehensive income and for each class of financial liabilities measured at amortised cost.

## Feedback on proposals

### *Usefulness and scope of proposed disclosure requirements*

6. Many respondents, including most standard setters, said that the proposed disclosures would provide useful information to users of financial statements. This view is supported by comments made by members of the Capital Markets Advisory Committee (CMAC) during their joint meeting with the Global Preparers Forum (GPF) in June 2023.

7. However, although not necessarily disagreeing with the proposed disclosure requirement, many other respondents, specifically banks and banking organisations, voiced strong objections against the proposed scope of the requirements. In their view such a broad scope will place a significant cost on preparers which will outweigh any perceived benefits to investors. Many of these respondents made suggestions for limiting the scope of the proposed disclosure requirements, including:

   (a) excluding financial liabilities (since there appears to be an overlap with existing requirements in paragraph B10A of IFRS 7);

   (b) excluding financial assets measured at fair value through other comprehensive income (since information about the fair value of these instruments is available);

   (c) excluding changes in cash flows due to changes in credit risk (since the credit risk disclosures in IFRS 7 already explain how credit risk is managed);

   (d) excluding changes due to 'increased cost clauses';

   (e) limiting the scope to ESG-linked features; or

   (f) limiting the scope to financial assets to which paragraph B4.1.10A of the ED is applied for contingent events that are not directly linked to basic lending risks or costs.

8. On the other hand, a few of these respondents believed that additional disclosure requirements are unnecessary since IFRS 7 already requires the disclosure of information that enables users to evaluate the significance of financial instruments for its financial position and performance and the post-implementation review (PIR) of the classification and measurement requirements of IFRS 9 did not provide evidence that users require additional disclosures.

### *Quantitative disclosures*

9. Comments on the proposed quantitative disclosure requirements proposed in subparagraph 20B(b) of the ED include suggestions:
   (a) to remove the requirement to disclose quantitative inforamtion since it would be costly for preparers to track and provide limited benefit to users, especially on an aggregated basis;
   (b) to reconsider the requirement to disclose the range of possible adjustments to contractual cash flows (as illustrated in the example in paragraph BC103 of the Basis for Conclusions on the ED) because the ends of the range could relate to low proability events that would not provide useful information to users of the financial statements; and
   (c) to include application guidance or illustrative examples to assist preparers in meeting the proposed requirements.

## Staff analysis and recommendations

### *Usefulness and scope of proposed disclosure requirements*

#### *Need for additional disclosure requirements*

10. As reported in Agenda Paper 3B for the April 2022 IASB meeting, some PIR participants suggested that the IASB add specific disclosure requirements to provide

users of financial statements with information about entities' exposures to changes in contractual cash flows linked to ESG factors.

11. The need for specific disclosure requirements was confirmed CMAC members during their joint meeting with the GPF in June 2022, who said that the following information would be useful:

    (a) the carrying amount of ESG-linked loans, including as a proportion of the total loans; and

    (b) the contractual conditions and their potential effect on future cash flows.

12. The staff note that paragraph 7 of IFRS 7 already contains a general requirement disclose 'information that enables users of its financial statements to evaluate the significance of financial instruments for its financial position and performance'. However, feedback from users of financial statements indicated that the existing requirements might not be sufficient to result in entities with financial assets or financial liabilities with ESG-linked or similar features to disclose information about changes to contractual cash flows because of such features.

13. The staff acknowledge concerns that the proposed scope for the additional disclosure requirements in the ED would not apply to a broader range of financial instruments than those with ESG-linked features (which was the issue raised in the PIR that resulted in the IASB proposing amendments to IFRS 9 and IFRS 7). The staff also agree with respondents that, in refining these proposals, the IASB should weigh up the additional costs to preparers against the usefulness of any proposed disclosure requirements. Before considering specific suggestions for limiting the scope of the proposed disclosure requirements, the staff believe it is worth revisiting the rationale behind the proposed disclosure requirements.

14. In seeking to clarify the application guidance in IFRS 9 on assessing the cash flow characteristics of financial assets, the IASB considered in which circumstances amortised cost is the most appropriate measurement basis (see paragraph BC43 of the Basis for Conclusions on IFRS 9). However, the staff believe that it is a separate

question as to whether the disclosures currently required by IFRS 7 for financial assets and financial liabilities measured at amortised cost provide sufficient transparency to users of financial statements about the existence of particular contractual features that could impact future contractual cash flows.

15. As noted in paragraph 17 of Agenda Paper 16 prepared for the October 2022 IASB meeting, there are currently no specific disclosure requirements in IFRS 7 that require the disclosure of the effect of contractual terms that change the timing or amount of contractual cash flows for financial instruments measured at amortised cost.

16. Applying the effective interest method to financial assets and financial liabilities measured at amortised cost requires an entity to estimate cash flows by considering all the contractual terms of the financial instrument. However, the proposed disclosure requirements in the ED were not intended to require a disclosure of any contractual terms that could result in a change to contractual cash flows.

17. The nature of a contingent event that results in a change in contractual cash flows is not itself a determinative factor in whether the contractual cash flows of a financial asset are solely payments of interest (see paragraph B4.1.10 of IFRS 9). Similarly, the nature of a contingent event does not always determine whether or not a financial liability contains an embedded derivative that should be separated. Nevertheless, the staff believe that the nature of the event could be qualitatively material even if it does not determine the way a financial instrument is measured. In such cases, disclosures are required to provide transparency about these contractual features.

18. The example of financial instruments with ESG-linked features is instructive. Although, as evidenced by the PIR feedback, there appears to be a growing market for financial instrument with these features, discussions with users of financial statements have indicated that they are often unaware of the presence and extent of such features in financial assets and financial liabilities. The purpose of adding specific disclosure requirements would be to provide users of financial statements with information about the prevalence of financial instruments with these and similar features as well as about the nature of the features and the possible impact on future cash flows. The purpose of

the proposed disclosures is not to report on the effectiveness of these instruments in achieving a reduction in greenhouse gas emissions or other stated objectives, but to provide information to users of the financial statements about contractual features that may be qualitatively or quantitatively material, either individually or in aggregate.

19. Although discussions have focused on financial instruments with ESG-linked features, the staff are of the view that the principle applies equally to other contractual features which could change contractual cash flows for reasons other than a change in basic lending risks or costs, for example, loans provided to banks by central banks with an interest rate that is adjusted based on the achievement of certain lending targets.

20. With this background, the paper next considers specific suggestions for limiting the scope of the proposed disclosure requirements.

*Excluding financial liabilities from the scope of the requirements*

21. The staff acknowledge comments made by respondents that there appears to be a potential overlap between the proposed disclosures for financial liabilities and the requirements in paragraph B8A of IFRS 7. However, respondents have not provided evidence that entities commonly disclose information about ESG-linked or similar features on the basis of the requirements in this paragraph.

22. The staff also note that paragraph B10A of IFRS 7 applies in the context of the disclosure of summary quantitative data about its exposure to liquidity risk, specifically if the outflows of cash included in the data could either occur significantly earlier than indicated in the data or be for significantly different amounts from those indicated in the data. The use of the terms ‘significantly different’ in this disclosure requirement impose a higher threshold than the usual consideration of whether information is qualitatively or quantitatively material, which is applicable to all disclosure requirements (see paragraph 31 of IAS 1 *Presentation of Financial Statements*). Although the type of contractual features that are being discussed in this paper could in some cases result in outflows of cash flows that are for significantly

different amounts and therefore would be in scope of the requirements in paragraph B10A of IFRS 7, this would not always be the case.

23. The staff are therefore of the view that the proposed disclosure requirements should also apply to financial liabilities measured at amortised cost, as proposed in the ED. The staff believe that the risk of duplicate disclosures is low, because IFRS 7 does not prescribe a specific location for disclosures to be provided in the financial statements to meet separate disclosure requirements. For example, paragraph B6 of IFRS 7 allows for cross-references to be made to disclosures in other reports.

*Excluding the financial assets measured at fair value thorough other comprehensive income*

24. The staff note the feedback that financial assets that are measured at fair value through comprehensive income are subject to similar disclosure requirements as financial instruments measured at fair value through profit or loss, such as the disclosure requirements in IFRS 13 *Fair Value Measurement.*

25. However, these instruments are accounted for in the same way as financial assets measured at amortised cost for the purposes of the statement of profit or loss. Therefore, to provide users of the financial statements with information about contractual terms that could impact the amounts recognised in profit or loss, the staff recommend retaining these instruments in the scope of the proposed disclosure requirements.

*Limiting the scope to ESG features*

26. The staff acknowledge suggestions to limit the disclosures to ESG features as the issue raised in the PIR relates specifically to financial assets with these features and having a clearly defined scope would limit the cost to preparers.

27. However, as mentioned in paragraph 19 of this paper, the staff are of the view that an ESG-linked feature is a good example of a contractual terms that should be disclosed to users of financial statements, but the need for disclosures are not limited to such

cases. Furthermore, although the term ESG is widely used, there is no generally accepted definition. There is also no conceptual basis for limiting these disclosure requirements to contractual terms that cash flows based on an ESG-linked target as opposed to other contingent events that are not directly related to basic lending risks or costs.

*Other ways of refining the scope of the proposed requirements*

28. The staff agree with respondents that the disclosure requirements as worded in the ED could be read to include contractual terms present in most ‘normal’ loans such as penalty interest rates or provisions for the loan to become payable on demand in the event of missed payments, breaches of loan to value ratios or debt coverage ratios or other proxies for increases in credit risk. The staff further agree that, in the case of financial assets, the cost of preparing such disclosures would likely outweigh the benefits of to the users of financial statements, since information about how the entity measures credit risk is already required in paragraphs 35A-38 of IFRS 7.

29. Furthermore, the staff believe that contractual terms that only change the timing rather than the amount of contractual cash flows would not provide information of possible future changes to the interest income or expense recognised on financial assets and financial liabilities and could therefore also be excluded from the scope of the requirements.

30. The staff also note that concerns about the term ‘specific to the debtor’ have already been discussed in paragraphs 18-21 of Agenda Paper 16 for the October 2023 meeting. The staff therefore believe that another basis should be found to determine the scope of the disclosure requirements.

31. The staff acknowledge suggestions to specifically exclude changes in contractual cash flows due to changes in basic lending risk or costs or to specify that the disclosure requirements are only applicable to those financial assets whose assessment of contractual cash flows depend on the proposed clarifications to the application guidance in IFRS 9. However, because the staff is recommending that the disclosure

requirements apply to both financial assets and financial liabilities, the staff do not think it is appropriate to link the proposed disclosure requirements directly to the application guidance in IFRS 9 that only applies to financial assets.

32. The staff believe that the contractual terms to which these disclosures are intended to apply could be described more directly by referring to contractual terms that change the amount of contractual cash flows based on a contingent event that does not directly relate to a change in basic lending risks or cost, such as the time value of money or credit risk.

33. Scoping the disclosure requirement in the manner described in paragraph 32 would be consistent with the IASB's tentative decision on clarifying the requirements for assessing the contractual cash flows of financial assets (see Agenda Paper 16A for the January 2024 IASB meeting). Although this assessment does not apply to financial liabilities, the staff believe that this refinement in scope of the disclosure requirements is nonetheless also appropriate for financial liabilities. Information about factors other than basic lending risks or costs that could change contractual cash flows would provide users of financial statements with the most useful information for both financial assets and financial liabilities.

34. Consistent with the requirements in IFRS 9, the staff do not recommend defining 'basic lending risks and costs' for the purposes of the disclosure requirements. However, the staff believe it would be helpful to include an example of a contractual term to which the disclosure requirements would apply, such as a change in interest rates based on the achievement of a greenhouse gas emission target.

35. The staff believe that framing the scope of the disclosure requirements in the manner described in paragraph 32 would provide useful information to the users of financial instruments while limiting the cost to preparers.

## Quantitative information requirements

36. The staff acknowledge concerns about the usefulness of quantitative disclosures, especially on an aggregated basis if the entity has many instruments with similar characteristics. However, as stated in paragraph 20C of the ED, the entity considers how much detail to disclose, the appropriate level of aggregation or disaggregation, and whether users of financial statements need additional explanations to evaluate any quantitative information disclosed. The staff believe that the judgements involved in presenting information in a useful manner is similar to what is required to comply with other disclosure requirements in IFRS 7 and therefore do not recommend removing the required to disclose quantitative information.

37. The staff also note concerns that providing a range of possible adjustments would not always provide useful information if the end points of the range are not representative of the most common types of adjustments.

38. As mentioned in paragraph BC103 of the Basis for Conclusions on the ED, in balancing the benefits for users of financial statements against the costs for preparers the IASB proposed a requirement to disclose the range of possible adjustments, as this information should be readily available to preparers and would not require a consideration of the likelihood of the contingent events occurring.

39. The staff still believe that the disclosure of a range of possible adjustments to contractual cash flows reflect what users of financial statements have said they would consider useful information. However, we acknowledge that there may be other quantitative information, such as the mean or modal value of the size of adjustments which could also provide useful information. The staff therefore recommend refining the requirement to require quantitative information about the adjustment to contractual cash flows and giving the range of possible adjustments as an example.

40. The staff do not think it is necessary to include illustrative examples of the disclosures required since the requirements are straightforward, and the precise format of the disclosures would depend on the nature of the entity's portfolio and the entity's judgement about the best way of presenting the information.