IFRS

STAFF PAPER

November – 2016

IFRS Interpretations Committee Meeting

Project	**IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement* – Fees and costs included in the '10 per cent' test for the purposes of derecognition**
Paper topic	Finalising whether to recommend an annual improvement or issue an agenda decision

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Introduction

1. This paper continues the IFRS Interpretations Committee ('the Interpretations Committee') discussions on which fees and costs should be included in the '10 per cent' test for the purpose of derecognition of a financial liability.

2. At its meeting in May 2016, the Interpretations Committee issued a tentative agenda decision. In that tentative agenda decision, the Interpretations Committee noted that when applying paragraphs B3.3.6 of IFRS 9 and AG62 of IAS 39 in carrying out the '10 per cent' test, an entity includes only fees paid or received between the entity and the lender, and fees paid or received by either the entity or the lender on the other's behalf.

3. At its September 2016 meeting, the Interpretations Committee reconfirmed the technical conclusions reached in May 2016 and summarised in the tentative agenda decision. The Interpretations Committee initially decided to recommend to the Board that it propose an amendment to IFRS 9 and IAS 39 as part of the next Annual Improvements Cycle. The Interpretations Committee subsequently requested the staff to bring the issue back before concluding on whether to recommend an Annual Improvement or issue an agenda decision.

4. This paper:

   (a) summarises the agenda criteria assessment (paragraph 5);

(b) suggests an initial draft of a possible narrow-scope amendment to IFRS 9 *Financial Instruments* in line with the Interpretations Committee's previous request (paragraph 6);

(c) includes additional considerations for deciding whether to recommend an annual improvement (paragraphs 7 - 13); and

(d) asks whether the Interpretations Committee wishes to recommend an Annual Improvement or issue an agenda decision.

Agenda Criteria

5. Staff's assessment of the Interpretations Committee's agenda criteria is provided below:

Paragraph 5.16 of the Due Process Handbook states that the Interpretations Committee should address issues:	**Agenda criteria satisfied?**
<u>As previously assessed in May 2016 and September 2016:</u>	
that have widespread effect and have, or are expected to have, a material effect on those affected;	**No**. Staff analysis of outreach results previously indicated that, while there is diversity in practice between entities, in most cases the issue did not have a material effect on entities.
where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods; and	**Yes**. Financial reporting would be improved through the elimination of diverse reporting methods.
<u>For completeness, the staff has assessed the remaining criteria below:</u>	
that can be resolved efficiently within the confines of existing IFRS Standards and the *Conceptual Framework for Financial Reporting*.	**Yes**. The matter can be resolved efficiently within the confines of IAS 39 and IFRS 9.

In addition:	
Can the Interpretations Committee address this issue in an efficient manner (paragraph 5.17)?	**Yes**. The issue can be addressed by the Interpretations Committee in an efficient manner
The solution developed should be effective for a reasonable time period (paragraph 5.21).	**Yes**. Staff is not aware of any current IASB projects that are likely to affect this issue.

Proposed drafting

6. In line with the Interpretations Committee's previous request, staff suggests an initial draft of a possible narrow-scope amendment to IFRS 9[1]:

> "For the purpose of paragraph 3.3.2, the terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid ~~net of any fees~~ or received between the lender and the borrower or fees paid by the lender or the borrower on their behalf and discounted using the original effective interest rate, is at least 10 per cent different from the discounted present value of the remaining cash flows of the original financial liability. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any incremental costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any incremental costs or fees incurred adjust the carrying amount of the liability and are amortised over the remaining term of the modified liability."

Annual improvement considerations

7. For a possible annual improvement, the Interpretations Committee will have to consider:

   (a) The additional criteria for annual improvements (paragraphs 8-9)

   (b) An effective date (paragraph 10)

[1] Any amendment to IAS 39 would be similar.

(c) Transition requirements (paragraphs 11-13)

Additional criteria for annual improvements

8. Staff's assessment of the additional criteria for annual improvements is provided below:

Additional criteria for annual improvements:	**Criteria for annual improvements satisfied?**
In addition to the implementation and maintenance criteria, an annual improvement should (6.11, 6.12): • Replace unclear wording; • Provide missing guidance; or • Correct minor unintended consequences, oversights or conflict.	**Yes**. On the assumption that current principles and requirements do not sufficiently address the situation described by the submitter, we think that paragraph B3.3.6 of IFRS 9 could be improved by replacing unclear wording. However, based on the principle and requirement provided in paragraph 3.3.2 and B3.3.6, staff think that the principles and requirements of IFRS 9 are sufficient to enable the entity to determine that the '10 per cent' comprises contractual cash flows only between the lender and the borrower.
Not change an existing principle or propose a new principle	**Yes**. We think that the proposed amendment would not change an existing principle nor propose a new principle.
Not be so fundamental that the IASB will have to meet several times to conclude (paragraph 6.14).	**Yes**. We think that the proposed amendment would not be so fundamental that the IASB will have to meet several times to conclude.

9. Based on the above assessment and on the assumption that current principles and requirements do not sufficiently address the situation described by the submitter, in the staff's view, the proposed amendment meets the additional criteria for an annual improvement. The additional criteria for annual improvement should only be evaluated if the agenda criteria are satisfied. In the staff's view, the agenda criteria are not satisfied (paragraph 5).

Earliest effective date

10. Based on the Board’s current project workflow, the earliest date by which an annual improvement could be issued as an exposure draft would be the latter half of 2017, which means an earliest effective date of 1 January 2019. This will be one year after the effective date of IFRS 9. Earlier application should be permitted.

Transition relief

11. We note that:

    (a) transition requirements of IFRS 9 include relief for items that have already been derecognised at the date of initial application of the Standard.

    (b) IFRS 1 *First-time Adoption of International Financial Reporting Standards* also includes relief for first-time adopters who need to apply the derecognition requirements of IFRS 9 only prospectively.

12. If no transition relief is provided for the proposed amendment, retrospective application of the proposed amendment might effectively eliminate the relief provided for derecognised liabilities in the transition requirements of IFRS 9. This is because the effective date will be after the effective date of IFRS 9.

13. Given the interaction with the requirements in IFRS 9 and cost benefit considerations, we propose that an entity should apply the proposed amendments prospectively.

Summary and question

14. In September 2016 the Interpretations Committee decided that further discussion was necessary before concluding whether to recommend an Annual Improvement or issue an agenda decision.

15. This paper:

    (a) summarises the agenda criteria assessment (paragraph 5);

(b) suggests an initial draft of a possible narrow-scope amendment to IFRS 9 in line with the Interpretations Committee's previous request (paragraph 6);

(c) includes additional considerations for an annual improvement (paragraphs 7 - 13); and

(d) asks whether the Interpretations Committee wishes to recommend an Annual Improvement or issue an agenda decision.

16. Appendix A reproduces the proposed wording for an agenda decision that was included in the September 2016 staff paper.

Question
Does the Interpretations Committee wish to recommend an Annual Improvement or issue an agenda decision?

Appendix A – proposed wording for an Agenda decision

In September 2016, the staff proposed the following wording for the agenda decision.

IFRS 9 Financial Instruments and IAS 39 Financial Instruments: Recognition and Measurement—Fees and costs included in the '10 per cent' test for the purpose of derecognition

The Interpretations Committee received a request to clarify the requirements in IFRS 9 and IAS 39 relating to which fees and costs should be included in the '10 per cent' test for the purpose of derecognition of a financial liability.

The Interpretations Committee observed the following:

a) paragraphs B3.3.6 of IFRS 9 and AG62 of IAS 39 require an entity to include 'any fees paid net of any fees received' in the '10 per cent' test when assessing whether the terms of an exchange or a modification of a financial liability are substantially different and lead to the derecognition of the original financial liability. Those paragraphs also include requirements regarding how to account for 'any costs or fees incurred' relating to the exchange or modification depending on whether that exchange or modification led to the derecognition of the financial liability.
b) In considering the items to include in the calculation of the effective interest rate, IFRS 9 and IAS 39 distinguish between 'fees and points paid or received between the parties to the contract' and 'transaction costs'. The Interpretations Committee noted that the objective of the '10 per cent' test is to quantitatively assess the significance of any difference between the old and new contractual terms by analysing the effect of the changes in the contractual cash flows (ie the contractual cash flows between the lender and the borrower). Consequently, the 'fees' included in the '10 per cent' test are similar to the 'fees and points paid or received between the parties to the contract' included in the calculation of the effective interest rate in that they represent contractual cash flows between the lender and the borrower. In contrast, 'any costs or fees' incurred relating to an exchange or a modification have a similar nature to 'transaction costs' in that they are costs directly attributable to the exchange or modification. (ie those costs or fees would not have been incurred if the entity had not exchanged or modified the financial liability).

On the basis of these observations, the Interpretations Committee noted that, when applying paragraphs B3.3.6 of IFRS 9 and AG62 of IAS 39 in carrying out the '10 per cent' test, an entity includes only fees paid or received between the lender and the borrower or fees paid by the lender or the borrower on its behalf.

In the light of the existing requirements in IFRS Standards, the Interpretations Committee determined that neither an Interpretation nor an amendment to a Standard was necessary. Consequently, the Interpretations Committee decided not to add this issue to its agenda.