STAFF PAPER

June 2017

IFRS® Interpretations Committee Meeting

Project	IFRS 9 *Financial Instruments*—Modifications and exchanges of financial liabilities
Paper topic	Agenda decision to finalise

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This paper has been prepared for discussion at a public meeting of the IFRS Interpretations Committee (the Committee). Comments on the application of IFRS Standards do not purport to set out acceptable or unacceptable application of those IFRS Standards—only the Committee or the International Accounting Standards Board (the Board) can make such a determination. Decisions made by the Committee are reported in IFRIC® *Update*. The approval of a final Interpretation by the Board is reported in IASB® *Update*.

Introduction and objective of the paper

1. The IFRS Interpretations Committee (the Committee) received a request regarding the accounting for a modification or exchange of a financial liability measured at amortised cost that does not result in the derecognition of the financial liability. More specifically, the request asked whether, applying IFRS 9 *Financial Instruments*, an entity recognises any adjustment to the amortised cost of the financial liability arising from such a modification or exchange in profit or loss at the date of the modification or exchange.

2. The Committee noted that the requirements in paragraph B5.4.6 of IFRS 9 apply to all revisions of estimated payments or receipts, including changes in cash flows arising from a modification or exchange of a financial liability that does not result in the derecognition of the financial liability. This is consistent with the requirements in IFRS 9 for modifications of financial assets that do not result in derecognition, and with the definition of amortised cost in Appendix A of IFRS 9 that applies to both financial assets and financial liabilities.

3. The Committee concluded, therefore, that an entity applies paragraph B5.4.6 of IFRS 9 to a modification or exchange of a financial liability that does not result in the derecognition of the financial liability. In doing so, the entity recalculates the

amortised cost of the modified financial liability by discounting the modified contractual cash flows using the original effective interest rate. The entity recognises any adjustment to the amortised cost of the financial liability in profit or loss as income or expense at the date of the modification or exchange.

4. The Committee noted that IFRS 9 had introduced additional wording in paragraph 5.4.3 of IFRS 9 on the accounting for modifications of financial assets. The Committee observed that, if an entity changes its accounting policy for modifications or exchanges of financial liabilities that do not result in derecognition as a result of the initial application of IFRS 9, then the entity applies the transition requirements in IFRS 9, which require retrospective application subject to particular relief as specified in Section 7.2 of IFRS 9.

5. The Committee concluded that the principles and requirements in IFRS 9 provide an adequate basis for an entity to account for modifications and exchanges of financial liabilities that do not result in derecognition. Consequently, the Committee tentatively decided not to add this matter to its standard-setting agenda.

6. The International Accounting Standards Board (the Board) also discussed this issue and agreed with the Committee's technical conclusions on the matter and also concluded that the principles and requirements in IFRS 9 provide an adequate basis to enable an entity to account for modifications and exchanges of financial liabilities that do not result in derecognition.

7. The purpose of this paper is to:

    (a) analyse the comments received on the Committee's tentative agenda decision; and

    (b) ask the Committee whether it agrees with the staff recommendation to finalise the agenda decision.

Comment letter analysis

8. We received 13 comment letters on the tentative agenda decision, which have been reproduced in Appendix B to this paper. The respondents' concerns, together with our analysis, are presented below.

Applying paragraph B5.4.6 of IFRS 9 to modifications and exchanges of financial liabilities

9. The Committee concluded that the requirements in paragraph B5.4.6 of IFRS 9 apply to all revisions of estimated payments or receipts, including changes in cash flows arising from a modification or exchange of a financial liability that does not result in the derecognition of a financial liability.

10. Some of the comment letters express concerns about that conclusion. Crédit Agricole S.A. and Mazars say that an exchange or modification is different from a revision of estimates of payments or receipts that occurs according to the original (unmodified) contractual terms of a financial instrument. Consequently, those respondents say the two cases should be analysed separately and possibly result in different accounting. The ANC shares this concern and expresses the view that entities should have an accounting policy choice because it is unclear whether paragraph B5.4.6 of IFRS 9 applies to a modification or exchange of a financial liability that does not result in the derecognition of the liability.

11. Other respondents noted that applying paragraph B5.4.6 of IFRS 9 to a modification of the interest rates charged does not represent the substance of the transaction. PwC, Mazars and Chatham Financial state that such a change in interest rate reflects a change in the economic characteristics of the liability *in future periods*. Mazars says it does not understand the relevance or economic rationale of the immediate effect on profit or loss that results from applying B5.4.6 of IFRS 9 in these situations. PwC and Chatham Financial say that such a change in interest rate would be more faithfully represented by the recognition of an increased or decreased interest expense over the remaining life of the borrowing, rather than by the recognition of a gain or loss at the

time of the modification and continued recognition of interest expense at the original effective interest rate (EIR). Acteo states that maintaining the original EIR would be acceptable only in instances where the renegotiation is minimal.

12. EY provides examples in which an interest rate switches from fixed to floating or vice versa, and from floating to floating with a change in credit spread. In those cases, EY says it would expect the agenda decision to refer to paragraph B5.4.5 of IFRS 9.

Staff analysis

13. The Committee discussed the application of paragraph B5.4.6 of IFRS 9 to modifications and exchanges of financial liabilities that do not result in derecognition at its November 2016 meeting (see agenda paper 6). The Committee observed that, upon modification, a modified financial liability continues to be the same original financial liability (if it is not derecognised). Because an entity retains the same financial liability, the Committee said that it does not consider that there is a basis on which to distinguish the accounting for changes in cash flows that arise from revisions of estimates from the accounting for cash flows that arise from modifications. Consequently, if a financial liability is not derecognised, the Committee considered that for both revisions of estimates and modifications an entity remeasures the amortised cost of the financial liability. An entity remeasures this amount by discounting the modified contractual cash flows using the financial instrument's original EIR. We continue to agree with the Committee's conclusions in this regard. Furthermore, respondents have not provided any new information beyond that considered by the Committee when reaching its tentative agenda decision.

14. We also note that paragraph B5.4.5 of IFRS 9 applies only to floating-rate financial instruments. When their cash flows are re-estimated to reflect movements in market rates of interest, the effective interest rate is updated. Paragraph B5.4.6 of IFRS 9, on the other hand, applies to fixed-rate instruments and will normally result in a change in carrying amount because the revised estimated cash flows are discounted at the instrument's original EIR. The required adjustment is recognised in profit or loss. An

entity cannot analogise to paragraph B5.4.5 of IFRS 9 to account for modifications or exchanges of fixed-rate instruments.

15. Consequently, we recommend the Committee does not make any changes to the wording of the tentative agenda decision in response to the concerns raised about applying paragraph B5.4.6 of IFRS 9 to a modification or exchange of a financial liability that does not result in the derecognition of the financial liability.

The treatment of modified cash flows versus costs and fees incurred

16. The tentative agenda decision stated that applying paragraph B5.4.6 of IFRS 9, if a modification or exchange does not result in the derecognition of the financial liability, then an entity recalculates the amortised cost of the financial liability by discounting the modified contractual cash flows using the original effective interest rate. The entity recognises any adjustment to the amortised cost of the financial liability in profit or loss as income or expense at the date of modification or exchange.

17. In contrast, paragraph B3.3.6 requires that any costs and fees incurred adjust the carrying amount of the liability and are amortised over the remaining term of the financial liability.

18. Some respondents expressed concerns about the different accounting treatment of a modification or exchange that does not result in the derecognition of the financial liability and any costs and fees incurred. Chatham Financial states that further clarification is required to explain how paragraphs B5.4.6 and B3.3.6 of IFRS 9 interact. Deloitte and EY say that in the absence of further guidance, this will continue to be a problematic distinction to draw and an area where structuring opportunities may arise.

Staff analysis

19. We acknowledge that the requirements for the accounting of fees and costs and the accounting for modified cash flows are different. However, we do not think that the Committee should address that difference as part of the agenda decision. The

accounting for fees and costs and its interaction with the accounting for modified cash flows is outside the scope of the question submitted and whether those requirements should be aligned is a broader issue than that addressed in the tentative agenda decision. Consequently, we recommend the Committee does not make any changes to the wording of the tentative agenda decision in response to the concerns raised about the requirements in paragraph B3.3.6 of IFRS 9.

Symmetry of the accounting for modified financial assets and modified financial liabilities

20. The tentative agenda decision stated that the requirements in paragraph B5.4.6 of IFRS 9 apply to a modification or exchange of a financial liability that does not result in the derecognition of the financial liability. The Committee noted that this is consistent with the requirements in paragraph 5.4.3 of IFRS 9 for modifications of financial assets that do not result in derecognition.

21. KPMG questions the purpose of the reference in the tentative agenda decision to the requirements for financial assets since the submission asks about the accounting treatment for modifications of financial liabilities. Acteo states that even though paragraph 5.4.3 of IFRS 9 is placed in the amortised cost section, that paragraph specifically addresses financial assets, not financial liabilities. They therefore say that a comparison should not be made for financial liabilities, since the accounting for assets and liabilities is not symmetric in many areas.

Staff analysis

22. The Committee previously discussed this topic in its November 2016 meeting (see agenda paper 6). The Committee observed that the requirements in paragraph 5.4.3 of IFRS 9 reflect that the modified contractual terms do not challenge the continuation of the original financial asset. In other words, the financial asset is the same as before the modification even though its contractual terms have been modified. Because the modified financial asset continues to be the same financial asset, its original EIR is used to discount the modified contractual cash flows. The Committee confirmed that

this analysis applies equally in the case of financial liabilities because the modified financial liability is the same original financial liability. Consequently, an entity determines the amortised cost of the modified financial liability by discounting the modified contractual cash flows using the original EIR of the financial liability.

23. The Committee’s conclusion is based on the fact that the definition of amortised cost in Appendix A of IFRS 9 applies equally to financial liabilities and financial assets. Consequently, when instruments are measured at amortised cost, the Committee confirmed that the principles underpinning the accounting for modifications of financial assets do not differ from the principles underpinning the accounting for modification of financial liabilities.

24. We continue to agree with the Committee’s conclusions in this regard. Furthermore, respondents have not provided any new information beyond that considered by the Committee when reaching its tentative agenda decision. Consequently, we recommend the Committee does not make any changes to the wording of the tentative agenda decision in response to the concerns raised about such symmetry.

Transition

25. The tentative agenda decision stated that if an entity changes its accounting policy for modifications or exchanges of financial liabilities that do not result in derecognition as a result of the entity’s initial application of IFRS 9, then the entity applies the transition requirements in IFRS 9, which require retrospective application subject to particular relief as specified in Section 7.2 of IFRS 9.

26. ESMA welcomes the reference to Section 7.2 of IFRS 9 in the tentative agenda decision. However, PwC, the ANC and Mazars say that specific transition provisions are necessary because retrospective application may be complex. Specifically, PwC says that such transition may require the reversal of changes made to the EIR, which in turn may affect the outcome of the entity’s analysis of whether subsequent modifications or exchanges result in derecognition.

27. KPMG asks what particular relief the Committee had in mind when drafting the tentative agenda decision and states that it is unlikely that the relief provided in paragraph 7.2.11 of IFRS 9 would be applied in practice. That paragraph states that an entity uses the fair value of the financial liability at the date of initial application of IFRS 9 as the new amortised cost of a financial liability if it is impracticable (as defined by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*) to apply retrospectively the effective interest method. Similarly, Mazars does not expect that relief to be available to entities because they think the threshold for impracticability is too high and therefore recommends that the Board provide prospective application for the approach stated in the tentative agenda decision.

Staff analysis

28. Similarly to other aspects of the transition to IFRS 9, we acknowledge that retrospective application of paragraph B5.4.6 of IFRS 9 may be complex in some cases. However, we think transition for this matter should be the same as the overall approach for applying IFRS 9 because we do not see a compelling case to provide special transition requirements for only this aspect of the classification and measurement requirements in IFRS 9. Consistently with Section 7.2 of IFRS 9, the Standard is not applied to items that already have been derecognised at the date of initial application and retrospective application of the requirements in paragraph B5.4.6 would be subject to impracticability relief. Furthermore, entities need not restate prior periods. If an entity does not restate prior periods, any difference between the previous carrying amount and the new carrying amount would be recognised in opening retained earnings.

29. Consequently, we recommend the Committee does not make any changes to the wording of the tentative agenda decision in response to the concerns raised about transition.

Derecognition when the '10 per cent' test is not breached

30. Acteo and EY ask the Board to clarify whether the derecognition requirements for financial liabilities in IFRS 9 require only a quantitative assessment (ie the '10 per cent' test) or whether qualitative factors must also be considered. Specifically, EY asserts that there are differing views in practice about which modifications result in 'substantially different terms' if the modification does not breach the '10 per cent' test. Similarly, ESMA suggests that the Committee could include in the final agenda decision a confirmation that the assessment of 'substantially different terms' of the modified or exchanged instrument considers both qualitative and quantitative tests, and clarify how to apply the qualitative test by providing examples of the terms to be assessed.

Staff analysis

31. While we acknowledge the feedback from respondents, we think that these questions about the derecognition requirements in IFRS 9 are too broad to be addressed in the agenda decision and are outside the scope of the issue submitted. The agenda decision addresses specifically the question submitted of whether an entity recognises an amount in profit or loss when a financial liability is modified or exchanged and that modification or exchange does not result in the derecognition of the financial liability. Consequently, we recommend the Committee does not make any changes to the wording of the tentative agenda decision in response to the concerns raised about other aspects of the derecognition requirements in IFRS 9.

An agenda decision as a mechanism to address the issue submitted

32. When the Committee initially discussed the submission, it tentatively decided to develop a draft Interpretation to explain the accounting for a modification or exchange of a financial liability measured at amortised cost that does not result in the derecognition of the financial liability. However, the Board expressed concerns about publishing such a draft Interpretation. As noted in paragraph 6 of this paper, the

Board concluded that the principles and requirements in IFRS 9 provide an adequate basis for an entity to account for modifications and exchanges of financial liabilities. Accordingly, the Board noted that a draft Interpretation would have been used principally as a means of highlighting the accounting already required by IFRS 9. The Board concluded that, in this situation, standard-setting is not required. As a consequence of the Board's discussion, the Committee tentatively decided not to add this issue to its agenda and published a tentative agenda decision in March 2017.

33. Many respondents express concerns about communicating the Committee's conclusion with an agenda decision, rather than with an Interpretation or an amendment to IFRS 9. Some respondents say that the requirements in IFRS 9 are not sufficiently clear to result in consistent accounting for the gains and losses arising from modifications and exchanges of financial liabilities that do not result in derecognition. Respondents state that there is a common understanding in practice that the requirements for liabilities (including their modification) are largely unchanged between IFRS 9 and IAS 39, which is indicated in paragraph BC4.51 of the Basis for Conclusions on IFRS 9. Those respondents expect that the agenda decision will result in a significant and unexpected change of current accounting practice.

34. Given the widespread impact of the issue and the existence of differing views in practice, the majority of respondents prefers that an authoritative mechanism is used to implement such a change. Respondents express the view that agenda decisions require less due process and generally receive less input from IFRS constituents compared to Interpretations or amendments to Standards and, as such, agenda decisions tend to receive limited attention and input from preparers. Respondents also say that an authoritative mechanism could reconsider whether specific transition provisions are appropriate or necessary for modifications that occurred before the pronouncement is effective.

35. As an alternative, Acteo, PwC, the ANC and Crédit Agricole S.A. suggest that the Board could also revisit the question submitted as part of the post-implementation review (PIR) of IFRS 9. Acteo states that only very significant and urgent issues

should result in amendments to IFRS 9 as entities require stability as a matter of priority.

Staff analysis

36. We note that while both the Committee and the Board concluded that the principles and requirements in IFRS 9 provide an adequate basis to enable an entity to account for modifications and exchanges of financial liabilities that do not result in derecognition, they acknowledged the importance of the issue. In particular, although the Board concluded that standard-setting is not required in this situation, it said that it will consider other ways to highlight this matter, for example, within a webcast. We think the feedback from respondents confirms the need for such other means, in addition to the agenda decision that includes explanatory material, to highlight the relevant accounting.

37. However, respondents have not provided any new information about the need for standard-setting beyond that considered by the Committee when reaching its tentative agenda decision. Consequently, we recommend that the Committee finalise the agenda decision in accordance with the IFRS Foundation *Due Process Handbook*.[1] We also recommend that the agenda decision is supported by other means to highlight the relevant accounting.

Staff recommendation

38. On the basis of our analysis, we recommend that the Committee finalise the tentative agenda decision as published in the March 2017 IFRIC Update. Appendix A to this paper outlines the draft wording for the final agenda decision.

[1] Paragraph 5.22 of the IFRS Foundation *Due Process Handbook* states: "If the Interpretations Committee does not plan to add an item to its work programme it publishes this as a tentative rejection notice in the IFRIC Update and on the IFRS Foundation website and requests comments on the matter. [...] After considering those comments the Interpretations Committee will either confirm its decision and issue a rejection notice, add the issue to its work programme or refer the matter to the IASB."

39. To address the respondents' concerns about the communication of the accounting requirements in IFRS 9 on this matter, we recommend producing additional material that highlights the relevant accounting. We will ask for input from the Committee and the Board on the best format for this material.

Question for the Committee
Does the Committee agree with the staff recommendation to finalise the agenda decision outlined in Appendix A to this paper?

Appendix A—Proposed wording for the final agenda decision

A1. We propose the following wording for the final agenda decision, which is unchanged from the tentative agenda decision except to remove the square brackets in the last sentence.

IFRS 9 *Financial Instruments*—Modifications or exchanges of financial liabilities that do not result in derecognition

The Committee received a request regarding the accounting for a modification or exchange of a financial liability measured at amortised cost that does not result in the derecognition of the financial liability. More specifically, the request asked whether, applying IFRS 9, an entity recognises any adjustment to the amortised cost of the financial liability arising from such a modification or exchange in profit or loss at the date of the modification or exchange.

The Committee noted that the requirements in paragraph B5.4.6 of IFRS 9 apply to all revisions of estimated payments or receipts, including changes in cash flows arising from a modification or exchange of a financial liability that does not result in the derecognition of the financial liability. This is consistent with the requirements in IFRS 9 for modifications of financial assets that do not result in derecognition, and with the definition of amortised cost in Appendix A of IFRS 9 that applies to both financial assets and financial liabilities.

The Committee concluded, therefore, that an entity applies paragraph B5.4.6 of IFRS 9 to a modification or exchange of a financial liability that does not result in the derecognition of the financial liability. In doing so, the entity recalculates the amortised cost of the modified financial liability by discounting the modified contractual cash flows using the original effective interest rate. The entity recognises any adjustment to the amortised cost of the financial liability in profit or loss as income or expense at the date of the modification or exchange.

The Committee noted that IFRS 9 had introduced additional wording in paragraph 5.4.3 of IFRS 9 on the accounting for modifications of financial assets. The Committee observed that, if an entity changes its accounting policy for modifications or exchanges of financial liabilities that do not result in derecognition as a result of the initial application of IFRS 9, then the entity applies the transition requirements in IFRS 9, which require retrospective application subject to particular relief as specified in Section 7.2 of IFRS 9.

The Committee concluded that the principles and requirements in IFRS 9 provide an adequate basis for an entity to account for modifications and exchanges of financial liabilities that do not result in derecognition. Consequently, the Committee ~~[~~decided~~]~~ not to add this matter to its standard-setting agenda.

Appendix B—Copies of comment letters

The Chairman of the IFRS IC
30 Cannon Street,
London EC4M 6XH,
United Kingdom.

15 May 2017

Dear Ms Lloyd,

IFRS 9 Financial Instruments: Modification or exchange of financial liabilities

We are writing this letter in reaction to the tentative decision as published in the March IFRIC update concerning the accounting for modification of financial liabilities under IFRS 9.

We have concerns about both the form and the substance of this agenda decision and we request the Board not to finalise it in its present state.

1. Should the Board consider that the problem of the modification of a liability is so important that it must be dealt with as a matter of urgency, we believe that this should be done by means of a standard amendment rather than a mere agenda decision. Indeed, an amendment will provide a proper Due Process with the opportunity for many stakeholders to comment on the rationale for the accounting outcome and may also provide specific transitional provisions. In addition, on the topic of the transition, entities will also have to address potential hedge accounting issues on these liabilities. Finally, because the accounting treatment will significantly change, entities should have the opportunity to reassess the qualification of the liability modification.

2. IFRS 9 contains no more precision concerning the accounting treatment of a liability modification than IAS 39. Even though IFRS 9 contains new requirements for the accounting for modifications of financial assets, we do not agree that a mechanical analogy should be made for liabilities, since the accounting for assets and liabilities is not symmetrical in many areas. We therefore believe that IFRS 9 is as silent on the issue as was IAS 39. Even though the paragraph 5.4.3 is placed in a section dealing with amortised cost, it specifically targets financial assets, not liabilities. As there is no basis for conclusion explaining this paragraph, one cannot conclude that the initial intention was that paragraph 5.4.3 also applies to liabilities.

Therefore, here again, we believe than an amendment rather than a mere decision agenda is needed to specify explicitly the accounting for those modifications of financial liabilities that do not result in derecognition.

3. Should the Board undertake to proceed with an amendment (as a result of the findings of the forthcoming PIR of the standard, for instance), we believe that it should not only deal with the accounting outcome of a liability modification but also with the initial assessment of the modification; currently, the requirement concerning the 10% test has been carried forward unchanged from IAS 39 to IFRS 9. We believe that some constituents could have interpreted paragraph AG62 as meaning that only a quantitative test should be performed. We believe that it is necessary to make it clearer that a qualitative assessment should also be performed. In this case, entities should also be able to reassess the qualification of their liabilities that have been modified.

   We also wonder whether it is relevant to maintain the original effective interest rate when a liability has been renegotiated. Doing so would create a mismatch between accountability and the way the liability is internally managed and analysed. The proposal to maintain the original rate could be acceptable only in those instances where the renegotiation is minimal. We therefore question the relevance of the 10% threshold for the quantitative test.

   At last, we believe that the difference between the accounting for modification and that for derecognition should be more clear-cut, with one leading to a P&L impact and the other not.

Finally, preparers are currently facing the implementation of 3 major new standards (IFRS 9, IFRS 15 and IFRS 16), which are very demanding both in time and human resources. Moreover, given the close deadlines for implementation, entities are more and more solicited to provide numerical estimates of the expected impacts.

In this context, we believe that no more changes should be proposed to IFRS 9, with the exception of very significant and urgent issues which could have very negative impacts if not resolved in time (such as the prepayment option issue). New issues may well emerge during the implementation phase, and certainly the standard warrants improvement in some areas, but entities need stability as a matter of priority. We therefore suggest waiting for the Post-Implementation Review before making changes to the standard if needed.

If you require any clarification or information, please do not hesitate to contact us.

Yours sincerely,

Patrice MARTEAU
Chairman

Mr Henry Rees
Director of Implementation and Adoption Activities
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

17 May 2017

Dear Henry

Interpretations Committee Tentative Agenda Decision: *IFRS 9 Financial Instruments* — Modification/exchange of financial liabilities that do not result in derecognition

We are responding to the IFRS IC's tentative agenda decision on *IFRS 9 Financial Instruments*— Modifications or exchanges of financial liabilities that do not result in derecognition, on behalf of PricewaterhouseCoopers. Following consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of member firms who commented on the rejection. "PricewaterhouseCoopers" refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We do not support the tentative agenda decision for the following reasons.

Firstly, we believe an agenda decision is not the appropriate mechanism to address this issue. We think it is not sufficiently clear from the wording of IFRS 9 that paragraph B5.4.6 (which requires the recognition of a gain or loss when an entity revises the estimated cash flows on a financial liability) applies to modifications of liabilities. In our view, whilst it is clear that paragraph B5.4.6 applies when there is a change in the entity's estimate of the cash flows that will arise under the contractual terms of a liability, it is not clear whether this paragraph also applies when those contractual terms are modified. We note that the common practice under IAS 39 today is to adjust the EIR of the borrowing rather than recognising a gain or loss at the time of modification. Furthermore, there is a common understanding that the requirements for liabilities (including their modification) are largely unchanged between IFRS 9 and IAS 39 – indeed the Board itself indicates this in IFRS 9 paragraph BC 4.51. Moreover, the *Due Process Handbook* paragraph 5.22 is clear that rejection notices do not have the authority of IFRSs. Accordingly, IFRS IC agenda decisions require less due process and input from IFRS constituents than Interpretations or amendments to standards and, as such, they tend to receive limited attention and input from preparers. For these reasons, in our view an IC agenda decision has insufficient visibility for what is a significant and unexpected change on a common issue.

Secondly, we think for some modifications of liabilities, applying the requirements of IFRS 9 paragraph B5.4.6 (i.e. recognising a gain or loss at the time of modification) would not faithfully represent the substance of the transaction. Two common examples are (i) an increase in the interest rate charged on a borrowing on the removal of a covenant (where the increased rate compensates for increased credit risk over the remaining term of the borrowing), and (ii) an extension of the term of a borrowing (where the new interest rate reflects current market rates for the additional term). These are detailed in Appendix I. In both of these common cases, the change in the interest rate reflects a change in the economic characteristics of the liability in future periods. This change is more faithfully represented by recognition of an increased (or decreased) interest expense over the remaining life of the borrowing, rather than recognition of a one-off gain or loss at the time of the modification and continued recognition of interest at the original EIR. For this reason, as well as the unclear wording in the standard, market practice has largely resulted in accounting for such modifications through an adjusted interest charge over the remaining life of the borrowing. We note that some such modifications may arguably be better accounted for by derecognition of the 'old' liability and recognition of a new one, which would result in the EIR being reset to current market rates. However, if the entity concludes there has not been a substantial modification, derecognition is not permitted.

Finally, we believe the absence of transition provisions is not appropriate in this case. In practice, multiple renegotiations of a borrowing can take place over many years. Therefore, retrospectively applying the requirements of IFRS 9 paragraph B5.4.6 may be complex. Retrospective application

may require reversal of changes made to the EIR of a borrowing, which in turn may affect whether any subsequent modification met the 10% test in IFRS 9 paragraph B3.3.6 such that the liability would have been derecognised. Hence, it may be necessary to reassess whether a past modification should retrospectively be accounted for as a derecognition event (rather than as a modification), as well as to recalculate the gain or loss that would have arisen at each of multiple modifications.

Given (i) that the agenda decision would represent a significant change from the common practice under IAS 39 in an area where the wording in IFRS 9 is unclear, (ii) the relatively consistent wording between IAS 39 and IFRS 9 in accounting for modification of financial liabilities and the statement in the basis for conclusions, which suggest there should be no change in practice, (iii) the broader interaction of modifications with derecognition, and (iv) the short time until the mandatory effective date of IFRS 9, we suggest the IFRS IC does not provide educative guidance in an agenda decision at this time. Rather we suggest the question is revisited by the Board as part of the IFRS 9 Post implementation Review.

If you have any questions in relation to this letter please do not hesitate to contact Paul Fitzsimon, PwC Head of Reporting and Chief Accountant (+1 416 869 2322), or Sandra Thompson (+44 207 212 5697).

Yours sincerely

PricewaterhouseCoopers

PricewaterhouseCoopers

Appendix 1 – Common examples of liability modifications

A. Loan covenant

An entity is close to breaching a loan covenant on a particular borrowing. It renegotiates the borrowing, to remove or amend the covenant in return for an increased interest rate that reflects the increased credit risk now associated with the borrowing. Recognising the effect over the remaining life of the borrowing is appropriate as removal of the covenant has resulted in a more risky borrowing, appropriately reflected in a higher subsequent EIR.

B. Extension of the term of a fixed-rate borrowing

An entity has had a fixed-rate borrowing for some years, during which time interest rates have fallen. The entity now expects it will need continued funding beyond the original maturity of the borrowing. It therefore renegotiates the borrowing, to extend its term. The future interest payments are reduced reflecting that interest rates have fallen, but there are no other changes to the terms. Adjusting the subsequent EIR of the borrowing reflects the effect the new interest environment has had on the borrowing's cash flows.

AcSB Accounting Standards Board

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May 22, 2017

By e-mail to ifric@ifrs.org

IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sirs:

Re: IFRS 9 *Financial Instruments:* Modifications or exchanges of liabilities that do not result in derecognition

This letter is the response of the staff of the Canadian Accounting Standards Board (AcSB) to the IFRS Interpretations Committee's tentative agenda decision regarding the accounting for an adjustment to the amortized cost of a financial liability arising from a modification or exchange that does not result in the derecognition of the financial liability.

The views expressed in this letter take into account comments from individual members of the AcSB staff.

We disagree with the Committee's decision not to add this item to its agenda. We think that the new wording introduced in paragraphs 5.4.3 and B5.4.6 is too subtle to result in consistent accounting for gains and losses on modifications and exchanges of financial liabilities that do not result in derecognition. Further, we think that other valid interpretations of these requirements of IFRS 9 are possible.

Our outreach to Canadian stakeholders has indicated that the most commonly observed approach under IAS 39 is to amortize gains and losses that are the result of a modification or exchange of a financial liability not resulting in derecognition over the remaining life of the financial liability. As a result, the Committee's technical conclusion on this issue may constitute more of a change in practice for Canadian stakeholders adopting IFRS 9 than previously anticipated.

Should the Committee decide to proceed with its tentative agenda decision, we think that it will be important to highlight this matter to raise awareness among entities that may need to change their accounting for modifications or exchanges of financial liabilities that do not result in derecognition as a result of the initial application of IFRS 9.

We would be pleased to elaborate on our comments in more detail if you require. If so, please contact me at +1 416 204-3464 (e-mail rvillmann@cpacanada.ca), or, alternatively, Michelle Thomas, Principal, Accounting Standards (+1 416 204-2979 or email mthomas@cpacanada.ca).

Yours truly,

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22 May 2017

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Comments on the Tentative Agenda Decision Relating to IFRS 9 *Financial Instruments*—Modifications or exchanges of financial liabilities that do not result in derecognition

1. The Accounting Standards Board of Japan (the "ASBJ") welcomes the opportunity to comment on the IFRS Interpretation Committee's (the "Committee") tentative agenda decision relating to IFRS 9 *Financial Instruments*—Modifications or exchanges of financial liabilities that do not result in derecognition in the March 2017 IFRIC Update.

2. We agree with the proposed clarifications to IFRS 9 regarding this issue. However, we believe that the proposed clarifications are not necessarily obvious from the existing requirements in IFRS 9. Considering the fact that the Committee has decided to address this issue because there was diversity in practice, we believe IFRS 9 should be amended so that all parties can understand the requirements appropriately, as intended by the IASB, solely from the text in IFRS 9.

3. Given that agenda decisions are not authoritative in nature, we think that issuing an agenda decision to clarify IFRS 9 on this issue is insufficient as a permanent measure.

4. Accordingly, we suggest amending IFRS 9 on this issue in the next Annual Improvements cycle.

5. We hope our comments are helpful for the Committee's and the IASB's consideration in the future. If you have any questions, please feel free to contact us.

Yours sincerely,

Yasunobu Kawanishi
Chairman of the Technical Committee for IFRS Implementation
Accounting Standards Board of Japan

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International Financial Reporting Standards Interpretations Committee
30 Cannon Street
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22 May 2017

Dear IFRS Interpretations Committee members,

Invitation to comment – Tentative Agenda Decision: IFRS 9 *Financial Instruments* - Modifications or exchanges of financial liabilities that do not result in derecognition (IFRIC Update March 2017 Agenda Paper 11)

Ernst & Young Global Limited, the central coordinating entity of the global EY organisation, welcomes the opportunity to offer its views on the above Tentative Agenda Decision (TAD) discussed by the IFRS Interpretations Committee (the IFRS IC) in March 2017.

We understand the rationale of the technical conclusion in the TAD that paragraph B5.4.6 of IFRS 9 applies to changes in cash flows arising from a modification or exchange of a financial liability that does not result in derecognition of the financial liability, given the clear requirements in IFRS 9 for modifications of financial assets.

However, we are of the view that the TAD highlights concerns with the requirements of IFRS 9 that only the International Accounting Standards Board (IASB) can resolve satisfactorily by amending the standard.

First, we are particularly concerned that finalising the TAD in this way would introduce a significant and undesirable opportunity for accounting arbitrage simply by labelling differently additional payments made by a borrower to a lender that are agreed as part of a modification. This could impair the comparability and transparency of financial statements. For instance, in our experience it is common for a borrower to agree to pay a lender a fee as part of the lender's agreement to the modification, and these fees are often material in amount. Paragraph B3.3.6 of IFRS 9 requires such a fee to be amortised over the remaining term of the modified liability, whereas the TAD says that the present value of other additional payments to the lender would be expensed immediately in accordance with paragraph B5.4.6 of IFRS 9. Nevertheless, as noted in the context of a related issue during the IASB's and IFRS IC's meetings in April 2017 and May 2016 respectively, such fees "are in substance indistinguishable from other contractual cash flows of the new debt instrument"[1] suggesting there should be no difference in the accounting treatment. Therefore, we believe that the

[1] Staff Paper 12A (April 2017 IASB Meeting), *Fees included in the '10 per cent' test for the purpose of derecognition*, paragraph 7, and Staff Paper 11 (May 2016 IFRS Interpretations Committee Meeting), *IAS 39 Financial Instruments: Recognition and Measurement / IFRS 9 Financial Instruments—Fees and costs included in the '10 per cent' test for the purpose of derecognition, paragraph 7*

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IASB should consider this issue further with a view to either eliminating the accounting arbitrage or developing requirements that more appropriately prescribe which additional payments are amortised and which result in an immediate expense.

Second, we believe that the TAD is not sufficiently clear as to situations in which the borrower should either keep an original effective interest rate (EIR) in accordance with paragraph B5.4.6 of IFRS 9 or revise the EIR in accordance with paragraph B5.4.5 of IFRS 9. An example would be where an interest rate switches from fixed to floating (or vice versa), and floating to floating with a change in credit spread. A literal reading of the TAD might be interpreted to require an entity to apply a paragraph B5.4.6 catch up approach even for modification from fixed rate to floating rate (or from floating to floating) which is the market rate at the time of modification, without any reference to paragraph B5.4.5. More importantly, we acknowledge that such modification might result in derecognition on the basis that there are now substantially different terms. However, this issue highlights the fact that there are different views in practice as to which modifications that do not breach the '10% test' would be regarded as resulting in substantially different terms and therefore lead to derecognition of the financial liability. IFRS 9 provides very limited guidance for modifications of financial liabilities in these circumstances and no guidance for modifications of financial assets. Therefore, we believe that the IASB should deal with this issue more broadly in the context of the derecognition requirements in IFRS 9.

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas at the above address or on +44 (0)20 7951 3152.

Yours faithfully

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Ms Sue Lloyd
Chair, IFRS Interpretations Committee
IFRS Foundation
30 Cannon Street
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Our ref MV/288
Contact Mark Vaessen

22 May 2017

Dear Ms Lloyd

Tentative agenda decision: *IFRS 9 Financial Instruments—Modifications or exchanges of financial liabilities that do not result in derecognition*

We appreciate the opportunity to comment on the above IFRS Interpretations Committee (the Committee) tentative agenda decision included in the March 2017 IFRIC Update. We have consulted with, and this letter represents the views of, the KPMG network.

Although we agree with much of the substantive accounting analysis in the Committee's tentative decision, we have the following concerns with the tentative agenda decision.

The tentative agenda decision states that the Committee noted that IFRS 9 had introduced additional wording in paragraph 5.4.3 of IFRS 9 on the accounting for modifications of financial assets. However, IFRS 9.5.4.3 addresses only the accounting for financial assets, not financial liabilities, and so the purpose of this reference is unclear. We believe that any change to the accounting for modifications of financial liabilities is not driven by IFRS 9.5.4.3 but by the changes to the wording of IFRS 9.B5.4.6 compared to IAS 39.AG8 which (especially when read in conjunction with the Basis for Conclusions to IFRS 9) imply that IFRS 9.B5.4.6 may apply to modifications of financial liabilities.

The tentative agenda decision does not mention the requirement in IFRS 9.B3.3.6 for fees incurred to adjust the carrying amount of the liability and be amortised over the remaining term of the modified liability. IFRS 9.B3.3.6 implies that fees paid by the borrower to the lender are excluded from the contractual cash flows accounted for in accordance with IFRS 9.B5.4.6 but instead impact the effective interest rate prospectively.

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The tentative agenda decision refers only to applying IFRS 9.B.5.4.6 and discounting at the original effective interest rate. Many constituents believe that, if the unmodified financial liability has a floating rate of interest and the modification reflects movements in market rates of interest, then the effective interest rate should instead be altered in accordance with IFRS 9.B5.4.5, normally resulting in no effect on the carrying amount. A similar question arises if the loan has a fixed rate of interest and the parties agree to modify the interest rate to a current market rate. Because the current treatment under IAS 39 generally is to adjust the effective interest rate, these issues will affect many constituents. The Committee should therefore consider the question of whether it is appropriate to adjust the effective interest rate in these cases, as leaving it unresolved may lead to significant diversity in practice.

The tentative agenda decision observes that, if an entity changes its accounting policy for modifications or exchanges of financial liabilities that do not result in derecognition as a result of the initial application of IFRS 9, then the entity applies the transition requirements in IFRS 9, which require retrospective application subject to particular relief as specified in Section 7.2 of IFRS 9. However, it is not clear what "particular relief" the Committee envisages. There are at least three reliefs that may be relevant: the relief in IFRS 9.7.2.1 from applying the standard to items that have already been derecognised at the date of initial application, the relief in IFRS 9.7.2.15 from restating comparative information and/or the relief in IFRS 9.7.2.11 for when it is impracticable to determine the effective interest rate retrospectively (although it seems unlikely the latter case would apply in practice).

Therefore, we think that the Committee should:

- Clarify that the change to accounting for modifications of financial liabilities is not driven by IFRS 9.5.4.3 but by the changes to the wording of IFRS 9.B5.4.6 compared to IAS 39.AG8;
- Mention the requirement in IFRS 9.B3.3.6 for fees paid to adjust the carrying amount of the liability and be amortised over the remaining term of the liability;
- Consider the question of whether it is appropriate to adjust the effective interest rate if a modification reflects movements in market rates and take action to forestall diversity in practice; and
- Clarify the particular relief(s) envisaged by the reference to Section 7.2 of IFRS 9.

Please contact Mark Vaessen +44 (0)20 7694 8871 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

KPMG IFRG Limited

KPMG IFRG Limited
Cc: Reinhard Dotzlaw, KPMG LLP (Canada)

Chatham Financial
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22 May 2017

The IFRS Interpretations Committee

30 Cannon Street

London EC4M 6XH

By email to: mhahn@ifrs.org

Re: IFRS 9 Financial Instruments - Modification or exchanges of financial liabilities that do not result in derecognition

Dear Mr Hahn,

Chatham Financial ("Chatham") is pleased to comment on the IFRS Interpretations Committee's ("the Committee") Tentative agenda decision regarding 'IFRS 9 Financial Instruments - Modification or exchanges of financial liabilities that do not result in derecognition' made at the March 2017 meeting of the Committee and as explained further in Agenda Paper 11 to that meeting (Agenda Paper 11).

Chatham serves as a hedging advisor to over 1,800 companies globally in many different industries. More than 500 of our clients apply the hedge accounting provisions of either International Accounting Standard ("IAS") 39 or International Financial Reporting Standard ("IFRS") 9, Financial Reporting Standard 102, or Accounting Standards Codification ("ASC") 815. We assist these companies with the application of hedge accounting on thousands of derivative transactions, which includes preparing hedge designation memos, effectiveness testing, derivative valuations, journal entries and disclosures for a variety of hedging relationships in many different industries. We also assist corporate clients with accounting for the refinancing of their borrowings, advising them on the application of the 10% test and associated accounting.

Our principal comments are as follows:

- We do not believe that requiring entities to recognise an **immediate gain or loss** in profit or loss arising from the adjustment to the amortised cost of the financial liability on modification or exchange of that liability represents an improvement to existing practice under IAS 39 (where such adjustments are often not recognised immediately but recognised over time via an adjustment to the effective interest rate).
- We agree with the Committee's initial conclusion (see paragraph 10 of Agenda Paper 11) that it would be appropriate to issue a draft interpretation in relation to this issue. This is in line with the outreach responses received (see Agenda Paper 6 of the November 2016 meeting of the Committee) that indicated under IAS 39 the most commonly observed approach is to **amortise** the gain or loss arising from a modification or exchange over the remaining term of the instrument via the effective interest rate. We believe an interpretation is required as the application of paragraph B5.4.6 of IFRS 9 to financial liabilities that have been modified or exchanged without resulting in derecognition, requires clarification given the variety in practice under IAS 39 in this area.

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We expand on these comments in the Appendix below.

We thank the Committee for its consideration of our comments and would be pleased to discuss these issues in more detail with the Committee or staff at your convenience. Please do not hesitate to contact me at +44 207 766 5731 or at kroberts@chathamfinancial.eu

Yours sincerely,

Kern Roberts
Director, European Accounting Advisory
Chatham Financial

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Appendix:

Requiring entities to recognise an immediate gain or loss in profit or loss arising from the adjustment to the amortised cost of the financial liability on modification or exchange of that liability, does not represent an improvement to existing practice under IAS 39.

As laid out in Agenda Paper 6 of the November 2016 meeting of the Committee, there are two main views in practice as to how modifications or exchanges of financial liabilities that do not result in derecognition should be accounted for:

- View One: Recognise a gain or loss at the date of modification (in line with the accounting described in IFRS 9 para. B5.4.6.)
- View Two: Do not recognise a gain or loss at the date of modification (but adjust via a revised effective interest rate).

In our view, mandating the application of View One will not be an appropriate reflection of the economic substance of the transaction in all cases.

To illustrate our concerns, we point to the example of large infrastructure projects, such as Wind Farm or Power Plant construction. These projects require very long term financing which is often provided in the form of floating rate bank debt. It is customary in such projects to refinance debt after construction is completed, as the risk profile of the project is transformed at that point. This strategy allows the project to borrow at a lower margin over Libor than what was originally agreed at inception. In many cases the only substantive change to the debt is the decrease in margin.

The economic substance of this transaction is that the principal amount owed has not changed, and the only amendment is to the interest charged over time (which has essentially been repriced to market rates appropriate for the new credit status of the project). In such fact patterns, we believe that recognising an immediate gain or loss simply does not reflect the economic substance, being reduced interest payments over time which is better reflected by adjusting the effective interest rate.

Furthermore, the borrowings in such entities can be extremely large relative to a single year of revenue and recognising the adjustment to amortised cost immediately could have a material impact on the income statement for that year, giving a view of financial performance that users of financial statements may find difficult to understand or reconcile to the economic circumstances.

The application of paragraph B5.4.6 of IFRS 9 to financial liabilities that have been modified or exchanged without resulting in derecognition, requires clarification given the variety in practice under IAS 39 in this area.

Agenda Paper 11 explains that the Committee concluded that the requirements of IFRS 9 para. B5.4.6 apply to **all** revisions of estimated payments or receipts, including changes in cash flows arising from modifications and exchanges of financial liabilities that do not result in the derecognition of the financial liability. We agree with the Committee's conclusion when paragraph B5.4.6 is considered in isolation.

However, it is also possible to conclude that the language in IFRS 9 para. B3.3.6 should be applied to changes in cash flows arising from modifications and exchanges of financial liabilities that do not result in the derecognition of the financial liability. Indeed many readers have concluded under IAS 39 para. AG62 that the following language:

"If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If the exchange or modification is not

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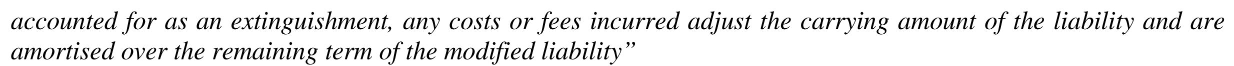

accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortised over the remaining term of the modified liability"

can be read to mean that there is no immediate gain or loss recognised in the specific case of modifications and exchanges of financial liabilities that do not result in the derecognition of the financial liability, and that all adjustments can be made via the effective interest rate. Being as this same language is now incorporated into IFRS 9 in paragraph B3.3.6, we believe that further clarification of how paragraphs B5.4.6 and B3.3.6 interact is required.

Putting aside our concerns as to whether the proposed accounting represents an improvement to the practice that had developed under IAS 39, we believe that clarification of the Standard is required if the IASB want to avoid the same variety of practice developing under IFRS 9 as developed under IAS 39. We have seen a Big Four interpretive text on IFRS 9 that explicitly concludes that both Views 1 and 2 laid out above remain appropriate under IFRS 9, so there has clearly been confusion in relation to the wording in IFRS 9 even amongst the technical accounting community. Consequently, we believe that given the significance of the change to practice that will arise from the tentative agenda decision and the confusion surrounding the language currently used in IFRS 9, the tentative agenda decision should be subject to the due process of an IFRIC interpretation as originally suggested by the Committee.

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Chairman

PDC N° 61

Paris, May 22nd , 2017

Mrs Sue Lloyd
IFRS Interpretations Committee
30 Cannon Street

LONDON EC4M 6XH
U.K.

March 2017- IFRS IC Rejection – IFRS 9 Financial Instruments – Modifications or exchanges of financial liabilities that do not result in derecognition

Dear Mrs Lloyd,

I am writing on behalf of the Autorité des Normes Comptables (ANC) to express our views on the above-mentioned IFRS IC tentative rejection published in March 2017 IFRIC Update "*IFRS 9 Financial Instruments – Modifications or exchanges of financial liabilities that do not result in derecognition".* This letter sets out the most critical comments raised by interested stakeholders involved in ANC's due process.

ANC does not support the tentative agenda decision to reject a request raising conceptual and practical issues and therefore asks IASB to consider issuing an authoritative position.

Current understanding in France is different from IFRS-IC tentative conclusion

With regards to changes in estimated future cash flows of a financial liabilities, the common understanding and practice of IAS 39 in France is that two situations have to be dealt with differently: adjustments resulting from renegotiations of financial liabilities are amortised over the remaining term of the liability (IAS 39.AG62); whereas changes in estimates of cash flows with no change of the contractual terms are recognised in profit or loss (IAS 39.AG 8).

The common understanding is that upon transition to the new standard, "*IASB decided to retain almost all of the existing requirements for the classification and measurement of financial liabilities*" (IFRS 9 BC 4.51). Indeed, both AG (application guidance) in IAS 39 have been carried forward in similar terms into the new IFRS 9 standard (IFRS 9 § B5.4.6 for IAS 39.AG 8 and IFRS 9 § B3.3.6 for IAS 39.AG 62). While IFRS 9 (§ B5.4.6) explicitly applies to changes in estimates of future cash flows within the frame of the contract, it is unclear whether it also addresses changes in estimated cash flows resulting from a modification of the contractual terms of a liability. Therefore, it was unclear whether the two distinct accounting treatments would still be applicable under IFRS 9. In our view, in the absence of authoritative guidance, both approaches are acceptable.

New provisions have been introduced with IFRS 9 § 5.4.3 on the accounting treatment of financial assets, where any change in the "*contractual cash flows of a financial asset [...] renegotiated or otherwise modified*" (absent derecognition) shall be recognised as "*a modification gain or loss in profit or loss*". This statement confirms the distinction between changes in cash flows resulting from a change in contractual terms (such as renegotiation or exchange) (addressed in § 5.4.3) and changes in estimates (dealt with IFRS 9 § B5.4.6) even if both accounting treatments are finally the same (immediate recognition in profit or loss). In addition, IFRS 9 § 5.4.3 only applies to financial assets and there is no such provisions for financial liabilities. This may support the understanding that issues and accounting treatments of modification of cash flows on the asset side could differ from those on the liability side.

The proposed change is worth an interpretation or an amendment

Based on the above, ANC does not share the view expressed by the Interpretation Committee that:

- the requirements in B5.4.6 (adjustment through P&L) "*apply to all revisions of estimated payments and receipts, including changes in cash flows arising from modifications or exchanges of financial liabilities*"; and
- the conclusion on the liability treatment has to be "*consistent with the requirements in § 5.4.3 relating to [...] financial assets*". Even if both financial assets and financial liabilities are measured at amortised cost, provisions in the standard regarding impairment, derecognition or changes without derecognition are currently different and may not lead to the same conclusion. Moreover, there are situations where immediate recognition of a contract renegotiation (absent derecognition) may not faithfully depict the substance of the transaction.

Therefore ANC does not concur with IASB considering that *"the principles and requirements in IFRS 9 provide an adequate basis to enable an entity to account for modifications and exchanges of financial liabilities that do not result in derecognition"*. A mere rejection notice is not sufficient and ANC concurs with IFRS IC's initial suggestion to issue a draft interpretation or encourages IASB issuing a clarification (narrow scope) amendment.

ANC's constituents were unaware that applying IFRS 9 for the first time would be such a change to their current practice and understanding of the accounting treatment to modifications and exchanges of financial liabilities. In ANC's view, using a webcast or any other non-authoritative guidance to present the IFRS IC position is not the most appropriate tool to deal with such a complex and unexpected issue. The absence of transition provisions is especially a matter of concern. A full retrospective application may prove complex (the retrospective application of derecognition tests on successive modifications could lead to very different conclusions).

We share the concern expressed by the IASB that the due process applicable to an amendment or an interpretation may unfortunately be incompatible with the effective date of IFRS 9 (i.e. 1 January 2018). Since a retrospective application would already apply on 1st January 2017, the effect of a rejection are however already incompatible. We therefore believe that the conceptual and implementation concerns are such, that only a proper due process involving all constituents can appropriately address this issue. Another approach could be to wait for the IFRS 9 post-implementation review.

Please do not hesitate to contact us should you want to discuss any aspect of our comment letter.

Yours sincerely,

Patrick de Cambourg

CRÉDIT AGRICOLE S.A.

FIG - DCC
Direction de la Comptabilité et de la Consolidation

Paris, the 22nd of May 2017

IFRS Interpretation Committee
30 Cannon Street
London EC4M 6XH
United Kingdom

Email: ifric@ifrs.org
Copy: mhahn@ifrs.org

Re: The March 2017 IFRIC Update - Committee's tentative agenda decision regarding IFRS 9 Financial Instruments—Modifications or exchanges of financial liabilities that do not result in derecognition (Agenda Paper 11).

Dear Mrs Lloyd,

As one of the largest banks in Europe, Crédit Agricole Group (CA Group, comprising the Regional Banks and Crédit Agricole S.A.) is the leading financial partner of the French economy through a customer-centric universal banking model. Being the no. 1 retail bank in Europe, the Group is also the leading European asset manager and bancassurer.

Accordingly, CA Group is highly impacted by IFRS 9 implementation and has been involved in a huge project since the beginning of 2015, including finance and risk and IT top management, and also all business lines. As part of the project, all interpretation issues regarding classification and measurement of both financial assets and financial liabilities have been duly analysed. As far as financial liabilities are concerned, we have not identified any change in IFRS 9 in comparison to IAS 39 except the own credit presentation issue for financial liabilities measured at fair value through P&L under the FV option.

We have paid special attention to the Committee's discussions regarding the topic of modifications and exchanges of financial liabilities and we do have serious concerns about the Committee's tentative agenda decision as it contradicts the way we currently apply IAS 39 and interpret IFRS 9, with unexpected consequences in the financial statements.

About the Committee's interpretation

First, may we draw your attention to the initial intent of the IASB in October 2010 when it issued additions to IFRS 9 for financial liability accounting: actually, the Board decided to carry forward the IAS 39 principles except the own credit amount issue. Moreover, the Board specified that it gave up on *"a symmetrical model for financial assets and financial liabilities* as *"the accounting requirements for financial liabilities in IAS 39 had worked well (...) and many respondents did not think that a fundamental change was needed to the accounting for financial liabilities"*[1].

[1] Feedback statement in October 2010 - additions to IFRS 9 for financial liability accounting: *"In July 2009 we published an exposure draft that proposed a symmetrical model for financial assets and financial liabilities. The feedback we received in response to that proposal was that the accounting requirements for financial liabilities in*

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FIG - DCC
Direction de la Comptabilité et de la Consolidation

As far as a financial liability's exchange or modification is concerned, we notice that IAS 39 and IFRS 9 provide similar principles, as IAS 39 paragraphs 40 and AG62 have been fully carried forward into IFRS 9 paragraphs 3.3.2 and B3.3.6. Similarly, accounting principles regarding "revisions of estimates" according to IAS 39.AG8 have been fully incorporated into IFRS 9.B5.4.6. Accordingly, we feel very uncomfortable with the Committee's tentative decision as it deals with a new interpretation of both IFRS 9 and IAS 39. Actually, it takes for granted that all modifications and exchanges of liabilities that are not accounted for as an extinguishment shall be reflected as "revisions of estimates" according to IFRS 9.B5.4.6, whereas we neither currently interpret nor apply IAS 39.AG8 that way.
Moreover, on a conceptual point of view, we believe that IASB shall reconsider the liabilities' modification or exchange treatment overall, as there is no evidence that paragraphs IFRS 9. B5.4.6 and IAS 39.AG8 should prevail in any case.
Actually, we are convinced that an "exchange or modification" is different from a mere "revision of estimates of payments or receipts" that might occur according to the original and unmodified contractual terms of a financial instrument. The two cases shall be analysed separately and possibly recognised differently.
We agree that clarifications are necessary to avoid divergent practices but we think that the issue shall be revisited as a whole. Additionally, we strongly advocate for any new clarifications to be submitted to public consultation before coming into force.

About the due process

We believe that the modification's treatment on the liability side is a "significant issue that have come to the attention of the IASB after IFRS 9 was published". Accordingly, it has to be addressed through the PIR due process and this issue shall result in an amendment to IFRS 9 with the appropriate clarifications and guidance, considering a minimum of a 120 days comment period.

About the implementation process

As the issue is complex and needs further IT developments before implementation in the financial statements, we believe that the IASB shall take into account a minimum of 1 year period

Finally, we urge the IFRS IC to reconsider its tentative decision, asking the IASB for further conceptual investigation with the objective to fulfil with the appropriate due process, adding amendments to IFRS 9 with the appropriate guidance.

Yours sincerely,

Isabelle Lefebvre

Director

Head of the Accounting and the Consolidation

IAS 39 had worked well. Most respondents did not think that a fundamental change was needed to the accounting for financial liabilities. The only issue that we were told needed urgent attention was the volatility in net income (P&L) caused by changes in the credit risk of financial liabilities that an entity has elected to measure at fair value.(...)"

Deloitte.

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22 May 2017

Sue Lloyd
Chair
IFRS Interpretations Committee
30 Cannon Street
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Dear Ms Lloyd

Tentative agenda decision – IFRS 9 *Financial Instruments*: Modifications or exchanges of financial liabilities that do not result in derecognition

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the March IFRIC Update of the tentative agenda decision not to take onto the Committee's agenda the request for clarification on the accounting for a modification or exchange of a financial liability measured at amortised cost.

We accept that the tentative agenda decision includes a valid analysis of the requirements of paragraph B5.4.6 of IFRS 9, but given the significant and widespread impact of this issue and the existence of other views on whether recognition of a gain or loss at the date of a transaction that does not result in significant changes to a financial liability is appropriate we recommend that this issue would be better addressed via a formal Interpretation rather than an agenda decision as this would allow for suitable transition provisions to be applied to adjustments arising from modifications that may have occurred some years ago.

In addition, we note that application of the approach described in the tentative agenda decision will be affected by the distinction between transaction costs incurred (which will be deducted from the carrying amount of the liability and amortised over the remaining term of the modified liability as required by paragraph B3.3.6 of IFRS 9) and cash flows that are part of the modification to a financial liability (which will form part of the remeasurement of the liability recognised in profit or loss at the date of the modification in accordance with paragraph B5.4.6 of IFRS 9). In the absence of further guidance, this will continue to be a problematic distinction to draw and an area where structuring opportunities can arise.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

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Yours sincerely

Veronica Poole
Global IFRS Leader

ISDA. Safe, Efficient Markets

The IFRS Interpretations Committee
30 Cannon Street
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By email to: mhahn@ifrs.org

22nd May 2017

Dear Sirs,

Re: IFRS 9 Financial Instruments - Modification or Exchanges of Financial Liabilities that do not Result in Derecognition

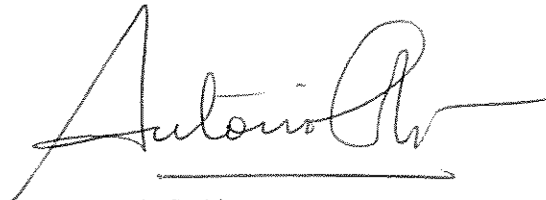
The International Swaps and Derivatives Association ("ISDA")[1] is pleased for the opportunity to respond to IFRS Interpretations Committee's (the "Interpretation Committee") tentative agenda decision made at its March 2017 meeting (agenda paper 11).

This relates to the treatment under IFRS 9 of any adjustment to the amortised cost of a financial liability arising from modification or exchanges that do not result in derecognition.

In light of the potential importance of the Interpretation Committee's tentative agenda decision to some preparers, we believe that the tentative agenda decision should be subject to the normal due process of an IFRIC Interpretation.

In the absence of such a process, there is risk that interested parties may not be aware and therefore miss the opportunity to comment.

Yours faithfully,



Lisa Bomba
Managing Director
Head of Accounting Policy & Advisory Group
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[1] Since 1985, the International Swaps and Derivatives Association has worked to make the global derivatives markets safer and more efficient. ISDA's pioneering work in developing the ISDA Master Agreement and a wide range of related documentation materials, and in ensuring the enforceability of their netting and collateral provisions, has helped to significantly reduce credit and legal risk. The Association has been a leader in promoting sound risk management practices and processes, and engages constructively with policymakers and legislators around the world to advance the understanding and treatment of derivatives as a risk management tool. Today, ISDA has over 850 member institutions from 68 countries. These members comprise of a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. ISDA's work in three key areas – reducing counterparty credit risk, increasing transparency, and improving the industry's operational infrastructure – show the strong commitment of the Association toward its primary goals: to build robust, stable financial markets and a strong financial regulatory framework. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

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European Securities and Markets Authority

THE CHAIR

Date: 22 May 2017
ESMA32-61-166

Sue Lloyd
IFRS Interpretations Committee
30 Cannon Street
London
EC4M 6XH
United Kingdom

Ref: The IFRS Interpretations Committee's tentative agenda decision on IFRS 9 - Modifications or exchanges of financial liabilities that do not result in derecognition

Dear Mrs Lloyd,

The European Securities and Markets Authority (ESMA) thanks you for the opportunity to respond to the IFRS Interpretations Committee's (IFRS IC) publication in the March 2017 IFRIC Update of the tentative agenda decision related to the application of IFRS 9 *Financial Instruments.* We are pleased to provide you with the following comments with the aim of improving the consistent application and enforceability of IFRSs.

ESMA has considered the IFRS IC's tentative decision not to add to its standard-setting agenda request the issue regarding the accounting for a modification or exchange of a financial liability measured at amortised cost that does not result in the derecognition of the financial liability. ESMA notes that the IFRS IC concluded that the principles and requirements in IFRS 9 provide an adequate basis for an entity to account for such modifications and exchanges.

ESMA agrees that IFRS 9 provides clear guidance related to the mechanics of the application of the amortised cost method when accounting for a modification or exchange of a financial liability measured at amortised cost that does not result in the derecognition. However, ESMA would like to express its concerns about the lack of appropriate guidance related to the question **when** modification or exchange of a financial liability results in its derecognition.

In particular, ESMA highlights the lack of guidance on how to apply the qualitative test when assessing whether the terms of the two liabilities are substantially different. Furthermore, ESMA would like to point to possible structuring opportunities that the lack of guidance could further aggravate. Finally, ESMA provides suggestions on the communication of the requirements related to derecognition of the financial liabilities as part of the implementation of IFRS 9. All these comments and concerns are further detailed in the Annex to this letter.

Therefore, in order to promote consistent application of IFRS and to set standards that are enforceable, ESMA urges the IFRS IC to provide additional guidance in the wording of the

agenda decision. Furthermore, we urge the IFRS IC to recommend to the Board either to reconsider its previous decision and to add the distinction between modification and derecognition of financial instruments to its active research agenda in the medium term, or to add this issue to the future post-implementation review of IFRS 9.

We would be happy to discuss these issues further with you.

Yours sincerely,

Steven Maijoor

Cc: Hans Hoogervorst, Chairman, International Accounting Standards Board

esma

Annex: ESMA concerns related to the tentative agenda decision

Guidance related to when modification or exchange of a financial liability results in its derecognition

1. While providing clarity to the mechanics of the application of the amortised cost method, the tentative agenda decision does not provide any additional guidance when a modification or exchange of financial liability results in its derecognition. This points to a more general issue, highlighted and reiterated by ESMA on several occasions[1] that neither requirements of IAS 39 *Financial Instruments: Recognition and Measurement* nor IFRS 9 do provide sufficient guidance to distinguish when a modification of a financial instrument results in its derecognition. ESMA regrets that this issue was not added to the active research agenda of the Board in the medium term as there is currently an uncertainty on under which circumstances modification of a financial instrument results in its de-recognition.

2. While limiting our comments in this letter to the accounting for modification or exchange of financial liabilities, we are of the view that the IFRS IC could provide additional guidance in this area. Although ESMA understands that the issue is complex and may be too broad to be resolved through an interpretation or agenda decision in its entirety, we consider that additional guidance on when modification or exchange of a financial liability results in its de-recognition is necessary in order to avoid diversity in accounting for this type of transactions, notably taking into account the current interest rate environment.

3. In particular, ESMA believes that the IFRS IC could:

   a) confirm and reiterate in the final agenda decision that the assessment of substantially different terms of the original and the modified/exchange instrument in paragraph 3.3.2 of IFRS 9 should be subject of both qualitative and quantitative test. That might entail a specific statement that although the difference in discounted present values of the instrument calculated according to paragraph B3.3.6 of IFRS 9 is below 10%, it might result in de-recognition if the terms of the instruments substantially differ from a qualitative perspective.

   b) Clarify in the agenda decision how to apply the qualitative assessment of substantially different terms in paragraph 3.3.2 of IFRS 9 by providing examples of terms to be assessed (such as change of governing law, amount, purpose of lending, term, maturity, covenants, collateral, guarantees etc.), similarly to the analysis made by the IFRS IC in its September 2012 agenda decision related to *Derecognition of financial instruments upon modification* (applied to the analysis of Greek Government Bonds).

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[1] E.g. Letter to the IFRS IC: The IFRS IC's tentative agenda decision on IAS 39 Financial Instruments: Recognition and Measurement – Holder's accounting for exchange of equity instruments, ESMA, October 2014, ESMA/2014/1211; Letter to the IFRS IC: Accounting exposure to Greek sovereign debt, ESMA, April 2012, ESMA/2012/248; Letter to the IASB: ESMA response to the IASB's Request for Views: 2015 Agenda Consultation, December 2015, ESMA, ESMA/2015/1740

Possible structuring opportunities

4. ESMA notes that the application of IFRS 9 requirements, as confirmed by the tentative agenda decision, can lead to the opportunities for structuring transactions due to the difference in the accounting outcomes between: (i) accounting for full derecognition; and (ii) accounting for a modification not resulting in derecognition as predominantly applied under IAS 39. Such transactions are common in the current low interest rate environment, when issuers might want to modify their liabilities by extending their maturities in order to lock-in the lower interest rates for a longer period. We note that the existence of these structuring opportunities[2] put additional pressure on including in IFRS 9 robust guidance related to when modification or exchange of a financial liability results in its derecognition in order to ensure consistent application of the derecognition guidance.

5. Simplified example below points to the different accounting outcomes described above:

Original instrument:	**New Instrument:**
Nominal: 100	Nominal value: 110 (fair value at the date of transaction)
Remaining maturity: 2 years	
Fair value: 110	Maturity: 10 years
Coupon 6%	Coupon: 3.6%
NPV at original EIR[3]/carrying amount: 100	NPV at original EIR: 90.6

Accounting impact	Full de-recognition	No de-recognition (IFRS 9 approach[4])	No de-recognition (predominantly observed approach under IAS 39[5])
Modification gain/loss	Loss (10)	Gain 9.4	N/a
Interest expense recognised for the new bond (annually)[6]	(4)	(5.9)	(5)

6. Using this example, the IFRS 9 accounting treatment when the modification or exchange of the financial liability does not result in its derecognition would lead to recognition of a gain of CU[7] 9.4 at the date of transaction, even though the fair value of the instrument being exchanged was CU 110. This means that there is a transfer of economic benefits to holders of the instrument in the amount CU 10 higher than the amortised cost of the original instrument. The loss of CU 10 would have been recognised at the date of the transaction if the liability was derecognised. The gain of CU 9.4 will be reversed over time, in the interest expense (original EIR) over the 10-year period. Consequently, total discount of CU 19.4 will be recognised over time in the higher than market EIR (CU 9.4 of the modification gain and CU 10 the difference between the fair value of the liability and its previous book value).

[2] ESMA notes that different structuring opportunities exist also in the high interest environment for the financial liabilities
[3] Effective interest rate
[4] As discussed by the IFRS IC leading to the tentative agenda decision
[5] The predominant approach under IAS 39 was to spread the modification gain/loss by adjusting the EIR. This is the approach under IAS 39 that was supported by the accounting literature (either as the appropriate accounting treatment or one of the treatments acceptable under IAS 39). Such treatment could be permissible given no guidance on objective of amortised cost calculation and modification of financial assets under IAS 39, which were introduced only by IFRS 9.
[6] Linear amount used as an approximation
[7] Currency Unit

Communication of the change

7. ESMA notes that no specific transition requirements between IAS 39 and IFRS 9 have been considered for this type of transactions. Therefore, ESMA welcomes that the wording of the tentative agenda decision reminds the general IFRS 9 transition requirements, which require retrospective application subject to impracticability test in Section 7.2 of IFRS 9.

8. Furthermore, we also note that this issue has not featured prominently as an important consideration for the IFRS 9 implementation. At this stage, we fear that agenda decision alone might not be a sufficient tool for explaining such a change in practice and a more substantive communication strategy might need to be employed by the IASB. Therefore, we welcome that the IASB plans to highlight the issue. ESMA notes that any communication should also explain reasons for the clarification of the accounting guidance from IAS 39 to IFRS 9 and the appropriate accounting treatment on transition in line with IFRS 9 transition requirements. The IASB should also acknowledge that under IAS 39 different accounting practices developed **given that the guidance was not explicit** on this issue, as documented by the predominant approach developed under IAS 39 and existing accounting literature. Moreover, ESMA encourages the IASB to make a widespread publicity around this agenda decision during its participation to conferences, meeting and other public events that can place sufficient prominence to the explanation of the IFRS 9 requirements in this area.

9. Taking into account this late development, ESMA highlights the need to evaluate the effects of the guidance on modification of financial liabilities, maybe through specific question within the post-implementation review of IFRS 9 in addition to the improvement of the existing guidance on the issue suggested above.

MAZARS

Mrs Sue Lloyd

IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH
United Kingdom

Paris, May 23, 2017

Tentative Agenda Decisions – IFRIC Update March 2017

Dear Sue,

MAZARS is pleased to comment on the various IFRS Interpretations Committee tentative agenda decisions published in the March 2017 IFRIC Update.

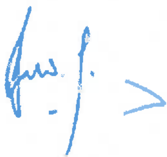
We have gathered all our comments as appendices to this letter, which can be read separately and are meant to be self-explanatory.

We would like to draw your attention to Appendix 2 on modified financial liabilities. We strongly believe that this issue, which could lead to a significant change to widespread accounting practices despite the absence of any clear change in IFRS 9 compared to IAS 39, cannot be dealt with through a simple agenda decision.

We consider that such a change deserves to be introduced through an authoritative pronouncement, being an Interpretation or an Amendment to IFRS 9, including appropriate transition relief, and following a sufficient due process that would allow the Board, the Interpretations Committee and all interested stakeholders to question the economic relevance of the outcome.

Should you have any questions regarding our comments on the various tentative agenda decisions, please do not hesitate to contact Michel Barbet-Massin (+33 1 49 97 62 27) or Edouard Fossat (+33 1 49 97 65 92).

Yours faithfully



Michel Barbet-Massin **Edouard Fossat**

Financial Reporting Technical Support

Appendix 2

IFRS 9 *Financial Instruments* — Modifications or exchanges of financial liabilities that do not result in derecognition (Agenda Paper 11)

Without wanting to prevent the IFRS IC from imposing a specific reading of IFRS 9 on the topic of exchanges/modifications of financial liabilities that do not result in derecognition, we disagree with the way the IFRS IC intends to proceed both in terms of due process and in terms of the transition requirements.
We develop hereafter the following points of concerns and remarks we would like to bring to the IFRS IC's attention.
The reading of IFRS 9 proposed by the IFRS IC contradicts a long standing generally admitted accounting treatment under IAS 39, whilst IFRS 9 in itself brings no modification to the requirements regarding liabilities compared to IAS 39. We therefore disagree with the fact that IFRS 9 is clear on the accounting treatment for financial liabilities. As a consequence, we consider that such a change should be implemented through an authoritative pronouncement. In addition, given the sometimes counterintuitive impacts that the proposed accounting treatment leads to, which are exacerbated in the context of retrospective transition, we strongly recommend that the Board introduce transition relief to allow prospective application of the new requirements.

A reading of the standard that contradicts a long-standing generally admitted accounting treatment under IAS 39

Debt renegotiation is a very common transaction and a large part of the past transactions have not met the derecognition criterion and were accounted for as debt modifications. Our experience is that, since 2005, the large majority of these transactions were dealt without any P&L impact upon modification. Indeed, IAS 39 AG62 requires the costs and fees incurred to be recognized as an adjustment to the carrying amount of the debt, then a new effective interest rate was calculated to take into account modified contractual cash flows as well as new costs or fees.

This has been a long-standing accounting practice, generally disclosed by entities as well as mentioned in audit firms' publications.

Our understanding is that IAS 39 AG8 was not applicable to such transactions as AG8 only refers to changes in cash flow estimates. Our understanding is that such changes in estimates were performed within the frame of existing contractual terms as required by IAS 39.9 (definition of Effective interest rate and Amortised cost). IAS 39 thus does not require paragraph AG8 to be applied to contractual modifications. We are convinced that there is a crucial difference between changes in estimates within an unchanged contractual framework, and changes in cash flows triggered by a contractual modification. AG8 has to be applied to the former, not to the latter.

We acknowledge that this position may not be the only way to interpret IAS 39 AG8, but we have found nothing in the IAS 39 standard & guidance that prohibits such a treatment. In practice a large majority of transactions have been dealt with in this way since 2005.
We note that the Tentative Agenda Decision takes this into account as it limits its analysis to IFRS 9 without questioning the accounting treatment under IAS 39. We welcome and support this approach.

IFRS 9 in itself brings no modification to the requirements regarding liabilities compared to IAS 39

IFRS 9 explicitly introduced a new accounting treatment for modified financial assets.
There is no such new requirement for modified financial liabilities. IAS 39 AG62 is identical to IFRS 9 B3.3.6 and IAS 39 AG8 is identical to IFRS 9 B5.4.6 with two exceptions:

- The introduction of a reference to the new requirements for modified assets
- A word "contractual" added to be more consistent with the wording of the definition of Effective interest rate.

We have not identified in these minor changes in wording any requirement to modify the accounting treatment that was generally retained under IAS 39 regarding liabilities. Upon the publication of IFRS 9, the significant impacts of the standard identified by stakeholders on the liability side were limited to the Own Credit Risk issue.

We note that IFRS 9 BC5.233 expresses a view on the scope of IAS 39 AG8 that is in contradiction with the then main accounting practice. This paragraph mentions that AG8 is to be applied to all changes in cash flows, including those arising from contractual modifications.

This could have been the initial intention of the Board (not expressed however at the date IAS 39 was issued), but we disagree that it is the only way to read the current requirements. We have not found any basis in the standard itself to justify this position.

We therefore disagree that IFRS 9 is clear on the accounting treatment of modified financial liabilities despite BC5.233, as the basis for conclusion is not an integral part of the standard. We agree that the proposed accounting treatment is a possible way to interpret IFRS 9 but in our opinion it is not the only one.

The treatment required by the IFRS IC is a significant change that should be introduced through an authoritative pronouncement

We consider that such a major change in the way a transaction has to be accounted for under IFRS should be addressed through an authoritative pronouncement.
We consider that the Board made the right choice introducing an explicit requirement for modified assets under IFRS 9. We encourage the Board either to do the same for modified liabilities or to ask the IFRS IC to issue a dedicated interpretation.
We note as well that derecognition requirements of IFRS 9 for financial liabilities are well understood and consistently applied. We therefore recommend that the Board limit the scope of this new requirement to the accounting requirements for financial liability modifications without opening a larger debate on the derecognition principles.

The P&L impact is not always consistent with the economic reality of debt modifications

We would also like to draw the attention of the Interpretations Committee to the fact that the proposed accounting treatment may provide counterintuitive P&L impacts.
This is for example the case when an entity renegotiates the interest rate of a fixed rate liability and extends its maturity to take advantage of current low market rates in exchange for the payment of a compensation fee representing the loss for the lender of the residual maturity of the initial liability.
In this case, the lender has not granted any economic benefit to the borrower. The lower interest rate is compensated by the fee received for the remaining maturity of the original debt, and the remaining part of the new debt is at current market conditions. We fail to understand the relevance and economic rationale of any upfront P&L impact in this situation.
Furthermore, the entity would then account for interest expenses at the original effective interest rate which is neither consistent with the interest being paid by the borrower nor with the current market conditions.
This accounting outcome can be counterintuitive and may puzzle users of financial statements (please refer to the illustrative example below). The accounting impact of a transaction is often taken into account before implementing it. Recent debt modifications may have been implemented differently were this new accounting requirement expected by issuers.
This is one of the reasons why we consider that such a new requirement should be accompanied by relevant transition relief.

Need for transition relief to alleviate counter-intuitive impacts on opening equity

The counterintuitive effects mentioned previously will be exacerbated in the context of a retrospective transition as illustrated in the example below.
Entities would not be able to use the "impracticability" exemption as per IAS 8 as its threshold is too high for them to justify not being able to reperform the calculations.
We therefore strongly recommend that the Board introduce transition relief that allows prospective application of this new accounting treatment.

ILLUSTRATIVE EXAMPLE

On January, 1st 2014, an entity borrows CU100 bearing an interest of 5% (corresponding to Libor (1%) + credit spread (4%) at that time) and the maturity of the loan is December, 31st 2018. The effective interest rate was 5% assuming the absence of transaction costs.

Application of the approach most used under IAS 39

The entity would account for the liability as follows:

Year	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018
Opening debt	100.0	100.0	100.0	100.0	100.0
Interest	5.0	5.0	5.0	5.0	5.0
Cash	-5.0	-5.0	-5.0	-5.0	-105.0
Closing debt	100.0	100.0	100.0	100.0	0.0

On January, 1st 2016, the entity, willing to take advantage of the fall of its credit spread, renegotiates the loan reducing its interest rate to 2% (Libor (1%) + credit spread (1%)) and extending its maturity to December, 31st 2021 in exchange for the payment of an indemnity of CU8.2. This fee fully compensates the lender for the change in interest rates for the last 3 years of the original debt. The new interest rate (2%) is consistent with current market conditions on the modification date.

Future cash-flows of the modified liability discounted using the original effective interest rate amount to CU93.0 (see below). This is 7% less than the amortized cost of the initial liability at the modification date. The entity concludes that this modification should not trigger derecognition of the debt.

in CU	01/01/2016	12/31/2016	12/31/2017	12/31/2018	12/31/2019	12/31/2020	12/31/2021	Total
Modified cash-flows	-8.2	-2.0	-2.0	-2.0	-2.0	-2.0	-102.0	
Discount factor at the original EIR	1.00	0.95	0.91	0.86	0.82	0.78	0.75	
Discounted cash-flows	-8.20	-1.90	-1.81	-1.73	-1.65	-1.57	-76.12	-93.0

10 per cent test (01/01/2016)	
Amortised cost of initial liability	100.0
New cash-flows discounted at original EIR	93.0
10 per cent test	**7%**

The accounting for the liability for the new residual duration of the liability would be the following:

in CU	01/01/2016	31/12/2016	31/12/2017	31/12/2018	31/12/2019	31/12/2020	31/12/2021
Opening liability	100.0	91.8	93.1	94.3	95.7	97.1	98.5
P&L impact due to renegotiation	0.0						
Interest expense (new EIR = 3.5%)	0.0	-3.2	-3.3	-3.3	-3.4	-3.4	-3.5
Cash	-8.2	-2.0	-2.0	-2.0	-2.0	-2.0	-102.0
Closing liability	91.8	93.1	94.3	95.7	97.1	98.5	0.0

First Time Application of IFRS 9

Applying retrospectively the approach selected by the IFRS IC as at January, 1st 2018 for the transaction described above, the entity would have to recognize a CU5 positive impact on equity on the transition date and a negative impact on the interest expense (the latter being calculated using the original EIR) for the new residual duration of the liability even if the interest paid by the entity did not change. The graph bellow illustrates the differences in terms of impacts

between the retrospective and the prospective application of the approach selected by the IFRS IC for the first time application of IFRS 9 and beyond: