AGENDA PAPER

IFRS Foundation Trustees meeting – Due Process Oversight Committee

SÃO PAULO	07 NOVEMBER 2017	**Agenda ref 1C**
CONTACT	Richard Thorpe	

Complaint about alleged breach of due process

Details of the complaint and DPOC protocol

1. On 16 October, we received a complaint about a breach of due process from someone who asked to remain anonymous (see below). This is about the process followed on the amendment to IFRS 9: *Prepayment Features with Negative Compensation.*

2. The *Due Process Handbook* includes (in Section 8) a Protocol for Trustee action for perceived breaches of due process. The immediate steps that we are taking in accordance with this Protocol are as follows:

a. Para 8.3 of the Handbook stipulates that we should post to the DPOC pages on the Foundation's website "each complaint, together with the name and contact details of the complainant". We posted this complaint to the website on 25 October, without including the complainant's name and address.

b. Para 8.4 requires a report from the appropriate technical staff in response to the complaint to be "posted on the DPOC web pages and…then considered by the DPOC at one of its meetings at which the Chair and/or Vice-Chair of the IASB are present". The detailed report is at AP 1Ci.

c. Para 8.4 also stipulates that the DPOC may request additional information from the Director of Trustees before finalising a response to the complainant. "The response of the DPOC, usually in the form of a letter to the complainant, is also posted on the DPOC web pages".

Decisions for the DPOC

3. The attached staff paper sets out the background to the issue and the due process steps that were taken by the Board and the IFRS Interpretations Committee. It also summarises (in paragraphs 18 and 19) the oversight that was provided by the Due Process Oversight

Committee. The staff conclusion (in paragraph 28) is that the due process requirements were met for this matter.

Does the DPOC agree that due process requirements were met, and that the letter to the complainant should explain this?

4. The next step in addressing this complaint will be for the chair of the DPOC to report orally on the issue to the Trustees meeting on 8 November, and then to write to the complainant and post the letter on the DPOVC webpages.

Does the DPOC agree to mandate the Chair of the DPOC and staff to draft a letter to the complainant as set out above?

AGENDA PAPER

IFRS® Foundation Trustees meeting – Due Process Oversight Committee

Sao Paulo	**November 2017**	**Agenda ref 1C(i)**
CONTACTS	Henry Rees/Liz Figgie	

Purpose

1. On 12 October 2017 the IASB issued *Prepayment Features with Negative Compensation* (Amendments to IFRS 9). As a result of those amendments, particular financial assets with prepayment features that may result in so-called negative compensation will be measured at amortised cost or at fair value through other comprehensive income, rather than at fair value through profit or loss.

2. Concurrent with the development of those amendments, at the request of the IFRS Interpretations Committee (Committee), the IASB also discussed the accounting required by IFRS 9 *Financial Instruments* for a modification or exchange of a financial liability measured at amortised cost that does not result in the derecognition of the financial liability. The Board decided that standard-setting was not required for that matter because the requirements in IFRS 9 provide an adequate basis for an entity to account for such modifications and exchanges. However, given the importance of addressing any uncertainty in practice in a timely manner, the Board decided to record in the Basis for Conclusions on the amendments to IFRS 9 for prepayment features with negative compensation its conclusion that standard-setting is not required, and to confirm the relevant accounting required by IFRS 9.

3. On 16 October 2017 we received a due process complaint related to those paragraphs included in the Basis for Conclusions on the amendments to IFRS 9. Specifically, the complainant says that the inclusion of those paragraphs breach the IFRS Foundation *Due Process Handbook* (Due Process Handbook).

4. The purpose of this paper is to describe the complaint received, set out the Board's and the Committee's respective discussions on this matter and consider

the assertions made by the complainant in order to further analyse whether the due process requirements were met.

5. As appendices to this paper, we have attached the following items:

   (a) the due process complaint received;

   (b) the paragraphs added to the Basis for Conclusions on the amendments to IFRS 9 for this matter;

   (c) IFRIC Updates from November 2016 and March and June 2017;

   (d) IASB Update from February 2017; and

   (e) Agenda Paper 6E for the June 2017 IFRS Interpretations Committee meeting, which summarises and analyses the comments received on the Committee's tentative agenda decision. (Attached as a separate paper.)

Summary of the due process complaint received

6. The complainant objects to the paragraphs that record in the Basis for Conclusions on IFRS 9 the Board's conclusion that IFRS 9 provides an adequate basis for an entity to account for modifications and exchanges of financial liabilities that do not result in derecognition, and confirm the relevant accounting requirements. The complainant expresses the view that those paragraphs attempt to establish a new IFRS requirement, while 'sidestepping' the standard-setting process.

7. The complainant says that the Board attempted to push the Committee to publish an agenda decision on this matter, and to dictate the accounting that the Board wishes to apply. Specifically, the complainant says that the Board decided to highlight this matter in the Basis for Conclusions on otherwise unrelated amendments to IFRS 9 after the Committee decided not to finalise a tentative agenda decision in the light of the comments received and instead to refer the matter to the Board. The complainant describes the technical analysis set out in that tentative agenda decision as 'unpopular' and 'flawed'.

8. The complainant expresses the view that the Board did not follow the Due Process Handbook when it decided to include those paragraphs in the Basis for Conclusions on the amendments to IFRS 9. Specifically, it says the Board did not

perform a ‘full and fair consultation’ as described in paragraph 3.41 of the Due Process Handbook or comply with the minimum safeguards described in paragraph 3.43 that require that any proposed Standard, amendment to a Standard or proposed Interpretation is exposed for public comment.

9. The complainant says that the Committee’s tentative agenda decision on this matter ‘should be dismissed’ as a form of exposure for comment given the relatively small audience that reviews the IFRIC Update. Furthermore, the complainant says there was no apparent consideration of the comments received. The complainant also questions why the Board did not perform the non-mandatory steps described in paragraph 3.44 of the Due Process Handbook such as holding public hearings and undertaking fieldwork.

10. Finally, the complainant says that the Board has ‘desecrated’ the Basis for Conclusions on IFRS 9 and that faith in the process must be restored.

Board and Committee discussions on the matter

11. The Committee discussed this matter at three meetings, and the Board discussed it at two meetings. The following paragraphs set out a summary of the discussions, and the conclusions reached, at those meetings.

12. At its November 2016 meeting the Committee began its discussions on the submission that asked about the accounting for a modification or exchange of a financial liability measured at amortised cost that does not result in derecognition of the financial liability. The Committee agreed with the technical analysis in the staff paper and concluded on the accounting required by IFRS 9, which is described in the IFRIC Update for that meeting. However, the Committee observed that the feedback from its outreach activities indicated that this would be a change in practice and that it would be beneficial to clarify that accounting and to make this visible. Consequently the Committee tentatively decided to develop a draft Interpretation, which would explain the accounting for such modifications and exchanges.

13. Paragraph 7.10 of the Due Process Handbook requires the Board to consider whether a draft Interpretation should be published. Accordingly, at its February

2017 meeting the Board discussed the submission received and the Committee's proposal to publish a draft Interpretation.

14. All 12 Board members agreed with the Committee's technical conclusions on the accounting required by IFRS 9 for the matter. However, the Board expressed concerns about issuing a draft Interpretation in this situation. The Board concluded that the 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 to highlight the accounting already required by IFRS 9. The Board concluded that, in this situation, standard-setting is not required and noted the potential knock-on implications for IFRS Standards more generally of creating a precedent of issuing an Interpretation even when the Committee and Board have both confirmed that the requirements provide an adequate basis to determine the required accounting. Consequently, all 12 Board members objected to publishing a draft Interpretation. The Board recommended that the Committee proceed with proposing an educative agenda decision on the matter, which would explain the relevant accounting requirements in IFRS 9. Given the importance of the matter, the Board also noted that it would consider other ways to highlight this matter, for example in a webcast.

15. At its March 2017 meeting we updated the Committee on the Board's discussion and asked the Committee whether it agreed with the Board's recommendation to publish an educative agenda decision to explain the relevant accounting requirements on this matter. The Committee agreed and tentatively decided not to add this matter to its standard-setting agenda. Instead, the Committee published a tentative agenda decision concluding that the 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. Consistent with the IFRIC Update published in November 2016 and the IASB Update published in February 2017, that tentative agenda decision explained the relevant accounting requirements in IFRS 9. The Committee's tentative agenda decision was exposed for 60 days as required by the Due Process Handbook.

16. At its June 2017 meeting the Committee discussed the 14 comment letters that had been received on the tentative agenda decision and the staff's analysis of

those comments.[1] Although continuing to agree with the technical analysis summarised in the tentative agenda decision, the Committee decided to refer the matter to the Board in the light of the comments received.

17. At its July 2017 meeting, the Board considered the main concerns raised in the comment letters received on the Committee's tentative agenda decision, as well as a summary of the Committee's June discussion. The Board reconfirmed its decision that standard-setting is not required because the 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. Given the importance of addressing any uncertainty in practice in a timely manner and to address the issue of visibility raised by the Committee, the Board decided to record that conclusion in the Basis for Conclusions on the amendments to IFRS 9 for prepayment features with negative compensation. Eleven of the 12 Board members agreed with those decisions, and agreed that the due process requirements have been met and that the Board has undertaken sufficient consultation and analysis.

Oversight by the DPOC

18. The Due Process Oversight Committee was informed about the Board's and Committee's discussions relating to this matter at its meeting in Tokyo in May 2017. The meeting summary records that the DPOC confirmed the Board's decision not to publish a draft Interpretation that had been proposed by the Committee to address modifications and exchanges of financial liabilities. The DPOC noted that the Board's decision was consistent with the requirements in the Due Process Handbook.

19. The DPOC was subsequently updated on the matter in its regular pre-Board meeting email on 12 July. Specifically, in that email the staff explained developments at the Committee's June meeting and noted that the Board would be

[1] Thirteen comment letters were included in the agenda paper for the Committee's June 2017 meeting. One additional letter was received after the comment deadline and was circulated to Committee members prior to the meeting. That additional letter did not provide any new feedback beyond that already described and analysed in the agenda paper.

considering the staff's recommendation to highlight the accounting required by IFRS 9 for a modification or exchange of a financial liability that does not result in derecognition when finalising the amendment to IFRS 9.

Analysis

20. The Board did not amend the requirements in IFRS 9 for modifications and exchanges of financial liabilities, nor did the Board issue an Interpretation on those requirements. Throughout their discussions on this matter, both the Board and the Committee agreed, and were clear on, the technical analysis of the *existing* accounting requirements in IFRS 9.

21. The Committee received 14 comment letters on its tentative agenda decision on this matter, which we acknowledge is a higher than usual response. While some of those comment letters disagreed with the technical analysis of the relevant accounting requirements in IFRS 9 or questioned whether other readings of the accounting requirements are possible, those letters did not provide any new information or analysis beyond that already considered by the Committee and the Board when reaching their technical conclusions. Other comment letters expressed a dislike for the *outcome* of those accounting requirements in IFRS 9 and in effect were requesting that the requirements be changed. Some comment letters expressed a preference for an amendment or an Interpretation, instead of an agenda decision. In that regard, some observed the analysis set out in the tentative agenda decision would result in a significant change in practice and expressed the view that an amendment or Interpretation would be a more appropriate mechanism to implement that change. For example, those mechanisms could provide transition relief and enable a longer period for the change. Other comment letters provided feedback on topics that were beyond the scope of the matter at hand. Both the Committee and the Board considered thoroughly the comment letters received on the Committee's tentative agenda decision. Neither body was persuaded to change its technical conclusions on the accounting required by IFRS 9.

22. We acknowledge that the technical analysis of the requirements in IFRS 9 will result in a change in practice. However, we disagree that such an outcome implies

that the requirements are unclear or the analysis is flawed. In fact, we expect that in most cases some change in practice will occur when the Committee considers a request and decides that standard-setting is not required. That is because interested parties generally submit questions to the Committee when there is diversity in practice.

23. As described above, the paragraphs that were included in the Basis for Conclusion on the amendments to IFRS 9 do not change or interpret the existing requirements in IFRS 9 for modifications and exchanges of financial liabilities. Instead, those paragraphs record the Board's conclusion that standard-setting is not required because the requirements in IFRS 9 provide an adequate basis for an entity to account for such modifications and exchanges, and confirm the relevant accounting required by IFRS 9.

24. The Basis for Conclusions confirms the *existing* requirements in IFRS 9. Since the Board did not issue a Standard, an amendment to a Standard or an Interpretation, we think the mandatory and non-mandatory steps in the Due Process Handbook that are referenced by the complainant are not applicable. The Committee's decision not to undertake standard-setting was exposed for public comment for 60 days through the usual process of exposing the Committee's tentative agenda decisions. As previously described, all of the feedback received was thoroughly analysed and discussed at public meetings of both the Committee and the Board. Therefore, we disagree with the complainant's assertion that there was no consideration of the comments received on the tentative agenda decision.

25. We acknowledge that the paragraphs that were added to the Basis for Conclusions on the amendments to IFRS 9 for this matter are not directly related to the subject of prepayment features with negative compensation. However, we think the matters are indirectly related because both are important to the proper application of amortised cost measurement in IFRS 9. Furthermore, we think the Board's decision to add these paragraphs to the Basis for Conclusions on IFRS 9 is consistent with the overall purpose of the Basis for Conclusions, namely to explain the Board's thinking and rationale for its decisions.

26. We note that in fact there have been instances in the past when the Board used the Basis for Conclusions in this way; ie instances in which the Board, when issuing

amendments to an IFRS Standard, also explained the application of other requirements in that Standard. For example, in April 2016, the Board issued *Clarifications to IFRS 15 Revenue from Contracts with Customers*. During the project that resulted in those amendments, the Board had decided not to amend IFRS 15 for particular issues that had been raised by the IFRS 15 Transition Resource Group. In the Basis for Conclusions on the amendments, the Board discussed its decision not to amend IFRS 15 for those particular issues and, as part of that discussion, also confirmed the relevant accounting requirements.[2]

27. Finally, we note that the Board ultimately decided to add the paragraphs on this matter in the Basis for Conclusions on the amendments to IFRS 9 because it acknowledged the importance of addressing any uncertainty about the requirements in IFRS 9 and diversity in practice in a timely manner. The Committee had emphasised the importance of visibility for this matter and the Board decided that such a mechanism would provide an appropriate level of visibility. The Board was aware and thus considered the fact that the technical analysis of the requirements in IFRS 9 might be unpopular, and a number of respondents would have preferred that the Board amend IFRS 9 to change the requirements, or to provide additional time for practice to change. However, we think those preferences are not matters of due process.

28. Consequently, based on the analysis above of the due process steps taken by the Board and the Committee, and the nature of the paragraphs added to the Basis for Conclusions on IFRS 9, we think that the due process requirements were met for this matter.

[2] For example, the Board decided not to amend IFRS 15 for an issue relating to assessing collectability. In paragraphs BC46B–BC46H of the Basis for Conclusions on IFRS 15, the Board took the opportunity to discuss that decision and, as part of that discussion, explained the relevant accounting requirements.

Due process complaint received

From: **IFRS Whistleblower** [mailto:ifrswhistleblower@gmail.com]

Sent: **16 October 2017 11:52**

To: **IASB** <IASB1@ifrs.org>; arculli@hk.kwm.com

Subject: **Due Process Complaint**

This email is intended to document a breach of the IFRS Foundation Due Process Handbook by the IASB in issuing the amendment to IFRS 9: "Prepayment Features with Negative Compensation". This breach lies not with the revised IFRS 9 text, or the process relating to the amendment with the same name as the document, but rather the inclusion of BC4.252 and BC4.253 within this document.

These paragraphs do not express a basis upon which the IASB reached a conclusion on the issue at hand. Indeed, these paragraphs are totally unrelated to the amendment in which they are included (hence the need for the heading, "Another issue", which immediately precedes these paragraphs). Nor do they, as a matter of fact, express a basis on which the IASB reached a conclusion in the issuance of IFRS 9. Instead, these paragraphs attempt to establish a new IFRS requirement, while sidestepping the standard setting process.

It is important to put this sidestep in context. This amendment to the requirements of IFRS 9 arose from the IASB's failed attempt to push the IFRS Interpretations Committee ("IFRIC") to reject a submission related to modification accounting for financial liabilities, and to dictate the accounting that the IASB wishes to apply in such circumstances.

The IFRIC had already referred this issue to the IASB, and suggested an amendment to IFRS 9. However, the IASB disagreed, and asked the IFRIC to instead issue a rejection notice stating that the accounting required by IFRS 9 was clear.

When the IFRIC issued a draft rejection setting out this information, as requested, it received 14 comment letters - a highly unusual number for an IFRIC rejection. None of these letters supported the proposed rejection notice. Some disagreed that the technical analysis was clear (or, indeed, correct). This view is founded on the fact that the words used for modifications of financial liabilities have not changed since IAS 39, and few - if any - preparers are currently applying those words in the way that the IASB wishes. In such circumstances it is quite challenging to demonstrate that the standard is clear in the way that the IASB/IFRIC proposed. Some commentators disagreed with the economic outcome of applying the draft rejection, noting that it defies common sense. Others noted that this was an important issue that required appropriate due process and an amendment to IFRS 9 to achieve this outcome. Some comment letters suggested all three of these as reasons for not progressing the issue.

When the IFRIC met in June 2017 to discuss the comment letters, there was insufficient support to push through an unpopular and flawed analysis of existing IFRS, and the matter was again referred back to the IASB.

In its July 2017 meeting, the IASB discussed the issue and decided not to follow the Due Process Handbook ("DPH"), but instead to include paragraphs in the Basis for Conclusion of an unrelated amendment, as noted above. Paragraph 3.41 of the DPH

Due process complaint received

would require "Full and fair consultation", as "wide consultation with interested and affected parties enhances the quality of its IFRSs." Unfortunately, however, this was not performed. The draft IFRIC rejection notice published in the IFRIC update passes under the radar of most users, and hence there was no wide consultation with interested and affected parties. Equally, the minimum safeguards in paragraph 3.43 of the DPH state that it is mandatory that any proposed Standard, amendment to a Standard or proposed Interpretation is exposed for public comment. This amendment to the Basis for Conclusions attempts to introduce an interpretation or amendment to the requirements of IFRS 9 that cannot be clear either from the existing words used (see comments above regarding IAS 39 and existing practice) or that is based on the discussions of the IASB at the time they were drafted, yet there was no exposure draft of these changes.

Even if the IASB were to argue that they believed that the draft IFRIC rejection notice was a form of exposure for comment, which should be dismissed given the relatively small audience that review the IFRIC update compared with Exposure Drafts for amendments to/new Standards issued by the IASB, part (c) of paragraph 3.43 is clearly not met, as there was no apparent consideration of the comments received on the rejection notice.

The non-mandatory "comply or explain" steps, such as holding public hearings and undertaking fieldwork, were also sadly lacking in the IASB's due process avoidance actions.

Having spoken with certain members of the IASB staff on this topic, it has been suggested to me that the Basis for Conclusions has, up until now, been considered 'sacred' - a reflection of the discussion undertaken at the time the particular words in the standard were drafted and why. To desecrate the Basis for Conclusions of IFRS 9 in this manner is an unwelcome development in standard setting by the IASB, and one that needs oversight from the DPOC and the Trustees to ensure that faith in the process is restored.

Regards

An IFRS whistleblower

Paragraphs added to the Basis for Conclusions on the amendments to IFRS 9

Another issue

Modification or exchange of a financial liability that does not result in derecognition

BC4.252 Concurrent with the development of the amendments to IFRS 9 for prepayment features with negative compensation, the IASB also discussed 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, at the request of the Interpretations Committee, the Board discussed 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.

BC4.253 The IASB decided that standard-setting is not required because the 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. In doing so, the Board highlighted that the requirements in IFRS 9 for adjusting the amortised cost of a financial liability when a modification (or exchange) does not result in the derecognition of the financial liability are consistent with the requirements for adjusting the gross carrying amount of a financial asset when a modification does not result in the derecognition of the financial asset.

Extracts from *IFRIC Update*

November 2016

IFRS 9 *Financial Instruments*—Modification or exchange of financial liabilities that do not result in derecognition (Agenda Paper 6)

The Interpretations Committee received a request regarding the accounting for modifications or exchanges of financial liabilities that do not result in derecognition of the financial liability. More specifically, the request related to 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 Interpretations 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 modifications or exchanges of financial liabilities that do not result in derecognition of the financial liability. The Interpretations Committee noted that this is consistent with the requirements in paragraph 5.4.3 of IFRS 9 relating to modifications of contractual cash flows of a financial asset that do not result in derecognition, and the definition of amortised cost in Appendix A of IFRS 9. In addition, in the case of a modification or exchange of a financial liability that does not result in derecognition, the financial liability continues to be accounted for as the same financial liability.

The Interpretations Committee concluded that, applying paragraph B5.4.6 of IFRS 9 to such modifications or exchanges of financial liabilities, an 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 Interpretations Committee observed that the feedback from outreach activities on practice applying IAS 39 *Financial Instruments: Recognition and Measurement* indicated it would be beneficial to clarify the accounting required by IFRS 9 for modifications or exchanges of financial liabilities that do not result in derecognition. Consequently, the Interpretations Committee tentatively decided to develop a draft Interpretation, which would explain the accounting for such modifications and exchanges.

Next steps

Subject to discussing with the Board, the staff will prepare the draft interpretation.

March 2017

Committee's tentative agenda decisions

The Committee discussed the following matters and tentatively decided not to add them to its standard-setting agenda. Instead, each tentative agenda decision includes, to the extent possible, educative material referring to the relevant principles and requirements in IFRS Standards. These tentative decisions, including the reasons for not adding the items to the Committee's standard-setting agenda, will be reconsidered at a future meeting. Interested parties who disagree with the tentative decision and/or with the reasons stated, or believe that such reasons may contribute to divergent practices, are

Extracts from IFRIC Update

encouraged to email their comments by 22 May 2017 to ifric@ifrs.org. Similarly, interested parties who agree with the tentative decision may also send us their comments by that date, indicating whether they agree with the Committee's reasons. All such correspondence received will be placed on the public record unless the writer specifically requests that it remain confidential. In that case, the request must be supported by good reason, eg commercial confidentiality.

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

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.

Extracts from IFRIC Update

June 2017

IFRS 9 *Financial Instruments*—Modification or exchange of financial liabilities that do not result in derecognition (Agenda Paper 6E)

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 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 discussed the staff recommendation to finalise an agenda decision. Although agreeing with the technical analysis summarised in the tentative agenda decision published in March 2017, the Committee decided to refer the matter to the Board in the light of the comments received.

Extract from *IASB Update*

February 2017

Modifications and exchanges of financial liabilities (Agenda Paper 12A)

The Board met on 22 February 2017 to consider the IFRS Interpretations Committee's (the Interpretations Committee) tentative decision to develop a draft Interpretation. Paragraph 7.10 of the IFRS Foundation Due Process Handbook requires the Board to consider whether a draft Interpretation should be published. The draft Interpretation would have addressed modifications and exchanges of financial liabilities measured at amortised cost that do not result in derecognition of the financial liability. The Interpretations Committee had concluded at its November 2016 meeting that the requirements in paragraph B5.4.6 of IFRS 9 *Financial Instruments* apply to all revisions of estimated payments or receipts—including changes in cash flows arising from modifications or exchanges of financial assets and financial liabilities that do not result in the derecognition of the financial asset or financial liability. This conclusion is consistent with the definition of amortised cost in Appendix A of IFRS 9. Applying paragraph B5.4.6, an 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.

All 12 Board members agreed with the Interpretations Committee's technical conclusions on the matter. However, the Board expressed concerns about issuing a draft Interpretation in this situation. 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, 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. However, given the importance of the matter, other means should be used to highlight the relevant accounting.

Consequently, the Board objected to issuing a draft Interpretation. All 12 Board members agreed with this decision.

Next steps

The Board recommended that the Interpretations Committee proceed with proposing an educative agenda decision on the matter, which would explain the accounting for modifications and exchanges of financial liabilities that do not result in derecognition applying IFRS 9. The Board will also consider other ways to highlight this matter—for example, within a webcast.

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

CONTACT(S) Markus Hahn mhahn@ifrs.org +44 (0)20 7246 6964

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.

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[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