IASB Meeting | Agenda reference 15C

Staff Paper | Date December 2009

Project **Derecognition**

Topic **Modifications of Financial Liabilities – accounting symmetry**

Contents and purpose of this paper

1. This paper addresses whether, in a contract modification that is accounted for as an extinguishment of a financial liability by the debtor (borrower), derecognition requirements for the financial asset of the creditor (lender) should be symmetrical.

2. Respondents to ED/2009/3 *Derecognition* (ED) asked the Board to address this issue.

3. This paper recommends that the accounting by the borrower and the lender should be symmetrical in such situations.

4. This paper only addresses symmetry in the context of derecognition.

Issue

5. IAS 39 *Financial Instruments: Recognition and Measurement* (IAS 39) does not provide for symmetry in the accounting by the debtor and the creditor for transactions involving the modification of the terms of a debt instrument.

6. On the debtor side, paragraph 40 of IAS 39 requires that a substantial modification of the terms of a financial liability or a part of it shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

7. On the creditor side, there are no such substantial modification rules for financial assets. Instead, there are transfer derecognition (and impairment) rules.

8. Paragraph 17 of IAS 39 requires that, if the contract has not expired, a financial asset is derecognised only if the entity transfers the asset and the transfer qualifies for derecognition. Modifications are outside the scope of a transfer and may often result in changes in measurement of the asset versus derecognition. This means that a borrower may apply different derecognition accounting than the lender on the modification of a contract.

9. The proposals in the ED are similar to the current guidance in IAS 39 and as such could also result in non-symmetrical accounting. [1]

Staff analysis

10. The staff believes that if, as a result of applying the accounting guidance, there is in effect a termination and replacement of an old contract with a new contract, it is logical that this would apply for both parties to the same contract.

11. Symmetrical accounting would also create more consistency between different types of transactions that have similar economic effects. For example, if cash is exchanged between a borrower and a lender to extinguish all or part of a liability, both the borrower and lender derecognise all or part of that liability/asset as appropriate. The staff believes that derecognition accounting should not differ just because the consideration paid/received is not cash (i.e. if instead of cash the borrower issues a new liability with different terms as consideration to the lender and the lender receives a new asset).

12. The staff researched the accounting requirements under IFRS and US GAAP (which are similar to the requirements in IAS 39) to understand why such symmetry, while apparently logical, has not been adhered to in the guidance on substantial modifications of contracts. However, in the time available, while the staff has speculated on various reasons for the differences, the staff has not been

[1] AP 15A discusses when modifications should result in extinguishment of a financial liability. AP 15B discusses the accounting for such situations. Although the accounting decisions may change based on the result of discussions of these agenda papers, the staff ‘s conclusions that symmetry is required will remain the same.

able to identify why substantial modification rules exist for financial liabilities and not for financial assets and as a result why the current accounting guidance results in asymmetry for these situations.

13. By contrast, the staff has not found reasons why these items <u>should not</u> be recognised consistently going forward.

14. Therefore, although the reasons for the prior inconsistencies remain unclear, the staff believes that if a contract has been substantially modified to the point that derecognition is required to faithfully represent the financial position of one of the parties to the contract, that conclusion should apply to all parties to the contract.

Staff recommendation

15. The staff recommends that the Board adopt the same accounting requirements for the modification and derecognition of all or a portion of financial assets that it does for financial liabilities, so that the accounting between the borrower and the lender are symmetrical.

Question
Does the Board agree with the staff recommendation that derecognition accounting by the borrower and lender, if an amendment to a contract meets the substantial modification criteria, should be symmetrical? If not, why not? What would you propose, and why?