Project: **Agenda Decision**

Topic: **IAS 39 *Financial Instruments: Recognition and Measurement* — Impairment of financial assets reclassified from available-for-sale to loans and receivables**

Introduction

1. In May 2010, the Committee published a tentative agenda decision not to add to its agenda a request received by the Committee for additional guidance on how an entity should account for the impairment of financial assets with a fixed maturity **after** they have been reclassified from the available-for-sale (AFS) category to loans and receivables.

2. The request identifies that during the financial crisis, a number of reporting entities reclassified certain financial assets in accordance with an October 2008 amendment to IAS 39 *Financial Instruments: Recognition and Measurement* in October 2008.

3. In many cases these financial assets were not impaired at the date of the reclassification, but were determined to be impaired at a subsequent reporting date.

4. The request asked for clarification on how the;
   (a) impairment loss should be recognised and measured; and
   (b) carrying amount of the financial asset should be adjusted after an impairment is recognised.

5. The Committee concluded that the agenda criteria were not met, because IAS 39 provides sufficient guidance on financial assets that are reclassified from AFS to

loans and receivables and that it does not expect significantly divergent interpretations (either emerging or already existing in practice).

6. Two comment letters were received.

7. The first comment letter[1] agreed with the tentative agenda decision made by the Committee, but proposed a change in one of the references included in the tentative agenda decision wording. The staff agree with this proposed change and have reflected it in the revised agenda decision wording in Appendix A.

8. The second comment letter[2] disagrees with the tentative agenda decision. This is because they believe that:

   (a) diversity in practice currently exists in relation to this issue;

   (b) the approach that the Committee believe is required by the current wording in IAS 39 leads to ‘over impairments’ in the period that a loss is recognised and an artificially high interest rate, and consequently high interest income, in subsequent reporting periods; and

   (c) the guidance in IAS 39 does not provide useful information to users.

9. The staff believe that the Committee considered in the May Committee meeting that, although some diversity may exist in practice in applying IAS 39 in this situation, there are not significantly divergent interpretations (either emerging or already existing in practice).

10. The staff also note that the Committee acknowledged the current approach in IAS 39 may lead to financial reporting outcomes that some consider are not decision-useful. However, the Committee noted that this has been recognised by the Board in decisions taken to date in the *Financial Instruments* projects.

11. As a result, the staff recommend that the tentative agenda decision is only changed to reflect the reference change noted above.

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[1] Deloitte Touche Tohmatsu
[2] Dutch Accounting Standards Board (DASB)

Staff recommendation and proposed wording of the final agenda decision
1. The staff recommends that the Committee finalise its tentative agenda decision not to add the issue to its agenda. Does the Committee agree with the recommendation? 2. Appendix A includes the staff's proposed wording for the final agenda decision which is only changed from the published tentative agenda decision to reflect a change in reference. Does the Committee agree with proposed wording?

Appendix A — Proposed wording for agenda decision

IAS 39 *Financial Instruments: Recognition and Measurement* — Impairment of financial assets reclassified from available-for-sale to loans and receivables

The Committee received a request for guidance on how an entity should account for the impairment of financial assets with a fixed maturity after they have been reclassified from the available-for-sale ('AFS') category to loans and receivables.

The Committee noted that paragraph 50~~C~~F of IAS 39 requires that the fair value of a financial asset on the date of reclassification becomes its new cost or amortised cost. A new effective rate of interest is then calculated and applied to the financial asset. This is the rate that discounts the estimated future cash flows to the new carrying amount of the financial asset. The Committee also noted that, when an impairment loss is recognised, applying the requirements of paragraph 54 of IAS 39 would result in all gains or losses that have been recognised in other comprehensive income being reclassified from equity to profit or loss.

The Committee noted that IAS 39 provides sufficient guidance on financial assets that are reclassified from AFS to loans and receivables and that it does not expect diversity in practice. Consequently, the Committee ~~[~~decided~~]~~ not to add this issue to its agenda.

DUTCH ACCOUNTING STANDARDS BOARD (DASB)

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Re : *Tentative IFRIC Agenda decisions in the May IFRIC meeting*

CC: EFRAG Technical Expert Group

Dear Mr. Garnett,

We would like to take this opportunity to comment on certain tentative agenda decisions of the IFRS Interpretations Committee (IFRIC) meeting of May 2010, as published on the IASB website.

Our concerns relate to three of the tentative decisions where we question the use of decisions not to add an issue to the agenda both from a procedural and from an accounting technical point of view:

- IAS 1 Financial Statement Presentation ─ Going concern disclosure;
- IAS 12 Income Taxes – Recognising deferred tax assets for unrealised losses on available-for-sale debt securities; and
- IAS 39 Financial Instruments: Recognition and Measurement ─ Impairment of financial assets reclassified from available-for-sale to loans and receivables.

Procedural point of view
In our view it is inappropriate to use agenda rejections as important interpretations with potentially widespread consequences. In the three instances referred to above, IFRIC decided not to take issues on the agenda whilst at the same time including accounting guidance in the rejection notice. In our opinion:

- the approach followed by IFRIC obstructs due process; and
- if the agenda criteria are not met, IFRIC should not make any IFRS interpretations.

Technical point of view (IAS 12 and IAS 39 related)
With regard to the agenda rejection of deferred tax assets for unrealised losses on AFS debt securities, we would like to highlight the following:

- In our opinion, IFRIC has not adequately reviewed all relevant aspects of this matter.

- IAS 12 *Income Taxes* is clearly written with deferred tax assets (DTA's) established through the P&L in mind. IFRIC is taking a very literal reading of IAS 12 and applies that by analogy to DTA's established through OCI.
- Furthermore, we believe that AFS reserves are by definition of a temporary nature, as impaired assets do not have any unrealised losses in OCI under IAS 39.

- Because the approach rejected by IFRIC is used widely in practice, the IFRIC agenda decision could have a significant impact and result in significant restatements to published financial statements based on an agenda rejection only.
- The proposed IFRIC decision would create a difference with existing US GAAP. It is our understanding that both methods as described in the staff paper are currently allowed under US GAAP. We note that these matters are also under consideration of the FASB in the US, but through a regular procedure with appropriate due process.

With regard to the agenda rejection of impairment of reclassified AFS, we would like to highlight the following:

- There is in practice no uniform interpretation of IAS 39 in this respect. The relevant paragraphs appear to be contradictory on certain points.
- The only approach that IFRIC now accepts, will lead to "over-impairments" in the period of an incurred loss, reversed through a too high effective interest rate in the periods after.
- We believe that the accounting approach prescribed by the draft rejection notice provides potential inappropriate information to users of the financial statements.

Obviously, we would be happy to discuss the above with you in more detail.

Yours sincerely,

Hans de Munnik
Chairman Dutch Accounting Standards Board

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Mr Robert Garnett
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14 June 2010

Dear Mr Garnett,

Tentative agenda decision: IAS 39 *Financial Instruments: Recognition and Measurement* — Impairment of financial assets reclassified from available-for-sale to loans and receivables

Deloitte Touche Tohmatsu is pleased to respond to the IFRIC's publication in the May 2010 IFRIC Update of the tentative decision not to take onto the IFRIC's agenda a request for an Interpretation of IAS 39 *Financial Instruments: Recognition and Measurement* with respect to accounting for the impairment of financial assets with a fixed maturity after they have been reclassified from the available-for-sale category to loans and receivables.

We agree with the IFRIC's decision not to take this item onto its agenda for the reasons set out in the tentative agenda decision. However, we note that the second paragraph of the tentative agenda decision refers to paragraph 50C of IAS 39, which addresses reclassifications out of fair value through profit or loss. We suggest the reference be changed to paragraph 50F of IAS 39 as this is the paragraph that addresses reclassification out of the available-for-sale category to loans and receivables.

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

Yours sincerely,

Veronica Poole
Global IFRS Leader - Technical