STAFF PAPER

July 2014

IFRS Interpretations Committee Meeting

Project	**Tentative Agenda Decisions to Finalise**
Paper topic	IAS 39 *Financial Instruments: Recognition and Measurement* Classification of a hybrid financial instrument by the holder

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We received the attached comment letters on 1 July 2014 after we had posted Agenda Paper 8. Consequently, these comment letters are not considered in the discussions in Agenda Paper 8.

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1st July 2014

Wayne Upton
Chair
IFRS Interpretations Committee
30 Cannon Street
London, EC4M 6XH

Re: Tentative Agenda Decision on IAS 39 *Financial Instruments: Recognition and Measurement* Classification of a hybrid instrument by the holder

Dear Mr. Upton:

I greatly appreciate the efforts of the IFRS Interpretations Committee in reaching out to diverse constituents around the globe and reflecting their opinions in the IFRS standards. On behalf of the KASB, I am writing this letter to deliver our opinion on the IFRS Interpretations Committee Meeting's tentative decision about IAS 39 *Financial Instruments: Recognition and Measurement* Classification of a hybrid instrument by the holder.

We are concerned that the tentative decision published in the March 2014 *IFRIC Update* not to include this issue on its agenda may not be able to provide sufficient rationale to entities regarding deciding the accounting treatment on similar issues raised in the submission. Although the *IFRIC Update*, relating discussion and staff paper reached the decision based on the responses of the outreach, the decision previously taken by IFRIC on classification of a hybrid financial instrument by the holder (November 2006 and January 2007) and the fact that this issue will no longer be relevant under IFRS 9, we believe that clearer direction about how to interpret similar issues in terms of accounting per se and whether it is a debt or an equity, is necessary.

This is because firstly, a strong possibility still remains that divergent views could exist on similar issues as the tentative decision does not provide clear context. Also, IFRS 9 will be effective as of January 1st 2018 with the early application allowed thus confusion will exist for a while even.

In detail, the reasons why clear interpretation is needed regarding this issue are as follows:

- In paragraph 16 in the staff paper for the IFRS Interpretations Committee Meeting in March 2014, we noted that various treatments could be possible depending on the discretionary interpretation of the issue. Therefore, we believe that sufficient evidence and references as to whether it should be debt or equity is required.

- If we refer to the decision previously taken by IFRIC on classification of a hybrid financial instrument by the holder (November 2006 and January 2007) to resolve this issue, paragraph 31 said that in the absence of implied or stated terms, judgement is required. Although this issue does contain stated and implied terms, those conflict with each other. Although the contract states the term as a certain number of years, in reality it

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is perceived as perpetual bonds. Therefore, it seems that there are controversies as to identifying embedded derivatives. Furthermore, depending on the legal terms of the contract, similar financial instruments that are the same in substance could be determined to be different from each other. For instance, if the restriction on dividends and the issuer's call option to redeem were added on the preferred stocks which act similarly to the underlying asset in the submission, the host contracts of the stocks may be concluded to be different from one another based on the form of the contracts.

- Although this type of issue will no longer be relevant under IFRS 9, it will take a few years until the effective date of the IFRS 9. Thus, the confusion and various treatments on similar issues are expected to linger on until the adoption of IFRS 9.

The KASB truly appreciates the Committee's deliberation of this issue, and understands that the Committee considers that the issue is not widespread and IFRS 9 will resolve this issue. However, for the reasons mentioned above, the KASB is concerned that making such a decision without providing clear context that helps resolve this issue might lead to a misleading conclusion, thus we believe a clear basis about how to interpret various forms of hybrid products would better be included in the final decision.

If you require further information on matters raised above, please do not hesitate to contact me or Heeyoung Kang (hykang@kasb.or.kr), Technical Manager of the KASB.

Best Regards,

Jee In Jang
Chair, Korea Accounting Standards Board

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30 June 2014

Re: Interpretations Committee tentative agenda decisions

Dear Wayne,

We are pleased to have the opportunity to provide our comments in order to contribute to the IFRS IC agenda decision (issued in March 2014) on IAS 1 – "*Disclosure requirements relating to assessment of going concern*" and on IAS 39 – "*Classification of hybrid financial instrument by the holder*".

IAS 1 – "Disclosure requirements relating to assessment of going concern"

The issue relates to the clarification about the disclosures required in relation to material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern.
We note that at its meeting in November 2013 the IASB also discussed this issue and decided not to amend requirements of IAS 1.
We note that the Interpretations Committee at its meeting in March 2014 discussed a different situation from the one discussed by the IASB. In such a different case, in which management of an entity has considered events or conditions that may cast doubt upon the entity's ability to continue as a going concern and concluded that there are no material uncertainties, the Interpretations Committee concluded that reaching this conclusion involved significant judgement and the disclosure requirements of para. 122 of IAS 1 would apply to this judgement.

We note that the Interpretations Committee issuing its tentative decision provide guidance on an unsolicited issue. In the past, we have already suggested Interpretations Committee to be careful that a rejection of an issue does not represent an interpretation. In addition, in any rejection's decision we would like that the Board has been involved.

In this specific case, we note that the Interpretations Committee not only provided additional guidance on an issue already rejected by the Board but it also changed facts and circumstances.

We think that this issue should be resolved by following the normal due-process to issue an interpretation or by transferring to the IASB to clarify whether the disclosure requirements of para. 122 of IAS 1 should apply to the case considered.

IAS 39 – "Classification of a hybrid financial instrument by the holder"

The issue relates to the classification of a hybrid financial instrument with a revolving maturity option, an early settlement option and a suspension of interest payment option by the holder. The submitter raises a question if the host of such financial instrument should be classified by the holder as an equity or as a debt instrument under IAS 39.
The Interpretations Committee, after having carried out outreach activities, observed that the issue is not widespread and that the financial instrument described is specific. In addition, according to the Interpretations Committee, IFRS 9 would resolve the question of whether the instrument should be classified before or after identifying the embedded derivatives because it would not require bifurcation for hybrid contracts with financial assets hosts and a holder would be required to classify the instrument as a whole.

On this position taken by the IFRS IC, we have the following comments.

- Although we recognize that the financial instrument could be specific, we think that similar types of financial instruments with the same or similar features are quite common among financial institutions.

- It is unclear whether IFRS 9 may be a solution. In fact, the holder could classify the hybrid financial instrument as a debt instrument or as equity instrument. In the first case, if the financial asset satisfy two conditions (a) the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows; b) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding) in accordance with para. 4.1.2 of IFRS 9, it shall be measured at amortised cost. If these conditions are not satisfied, the debt instrument shall be measured at fair value through profit or loss. In the other case in which the entity classifies the hybrid financial instrument as an equity instrument and this is not held for trading, it could present in other comprehensive income subsequent changes in the fair value of the investment according to para. 5.7.5 of IFRS 9. Therefore, we note that in the case described by the submitter the hybrid financial instrument could be measured at fair value through profit or loss (if the entity classifies it as debt instrument) or at fair value through other comprehensive income (if the entity classifies it as equity instrument that is not held for trading and apply the FVTOCI option).

Should you need any further information, please do not hesitate to contact us.

Yours sincerely,
Angelo Casò
(Chairman)