

STAFF PAPER

September 2016

IFRS® Interpretations Committee Meeting

Project	IFRS 9 <i>Financial Instruments</i> and IAS 39 <i>Financial Instruments: Recognition and Measurement</i>—Fees and costs included in the ‘10 per cent’ test for the purpose of derecognition		
Paper topic	Comment letter analysis and finalisation of agenda decision		
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This paper has been prepared for discussion at a public meeting of the IFRS Interpretations Committee (the Interpretations Committee). Comments on the application of IFRS Standards do not purport to set out acceptable or unacceptable application of IFRS Standards—only the Interpretations Committee or the International Accounting Standards Board (the Board) can make such a determination. Decisions made by the Interpretations Committee are reported in IFRIC® *Update*. The approval of a final Interpretation by the Board is reported in IASB® *Update*.

Introduction

1. In May 2016, the IFRS Interpretations Committee (‘the Interpretations Committee’) discussed which fees and costs should be included in the ‘10 per cent’ test for the purpose of derecognition of a financial liability.¹ More specifically, the Interpretations Committee discussed whether an entity includes fees and costs incurred on the modification or exchange of a financial liability that are paid to third parties in the ‘10 per cent’ test.
2. The Interpretations Committee noted that the objective of the ‘10 per cent’ test is to quantitatively assess the significance of any difference between the old and new contractual terms by analysing the effect of the changes in the contractual cash flows between the lender and the borrower. The Interpretations Committee noted that IAS 39 and IFRS 9 distinguish between ‘fees and points paid or received between the parties to the contract’ and ‘transaction costs’. The former represent contractual cash flows between the lender and the borrower and the latter represent costs directly attributable to the exchange or modification. Consequently, the Interpretations

¹ The paper discussed at the Interpretations Committee meeting in May 2016 can be found at: [http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2016/May/AP11-Fees and costs included in the 10 per cent test for the purpose of derecognition.pdf](http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2016/May/AP11-Fees%20and%20costs%20included%20in%20the%2010%20per%20cent%20test%20for%20the%20purpose%20of%20derecognition.pdf)

Committee noted that in carrying out the ‘10 per cent’ test, an entity includes only fees paid or received between the lender and the borrower or fees paid by the lender or the borrower on its behalf.

3. The Interpretations Committee noted that the staff outreach identified that there is diversity in practice among entities applying the requirements in IAS 39, which can be expected to persist when entities apply IFRS 9. However, some respondents to the outreach said that in most cases the consideration of third-party fees would not affect the outcome of the ‘10 per cent’ test, which therefore alleviates the perceived lack of consistency in the application of the requirements relating to this test.
4. On the basis of the existing requirements, the Interpretations Committee decided that neither an IFRIC Interpretation nor an amendment to the Standard was necessary. Consequently, the Interpretations Committee published a tentative agenda decision not to add this issue onto its agenda.²

Purpose of the paper

5. The purpose of this paper is to:
 - (a) provide a summary of the comments received on the tentative agenda decision;
 - (b) analyse the comments received; and
 - (c) propose finalising the agenda decision.

Summary of comment letters

6. The comment period for the tentative agenda decision ended on 22 July 2016. We received three comment letters, which are reproduced in Appendix B to this paper.
7. The main comments received are as follows:
 - (a) Deloitte agreed conceptually with the technical conclusion reached by the Interpretations Committee; however, they also said that they are not convinced that the guidance cited in the tentative agenda decision is

² The tentative agenda decision can be found at:
<https://s3.amazonaws.com/ifrswebcontent/2016/IFRIC/May/May-IFRIC-2016.pdf>

sufficient to preclude a broader interpretation. They are of the view that a more significant clarification of the Standards was warranted as well as explicit transition provisions. Consequently, Deloitte concluded that the issue would be better addressed by an amendment to IFRS 9 and IAS 39 as part of the Annual Improvement project or by way of an Interpretation.

- (b) the Accounting Standards Committee of Germany (ASCG) raised a similar concern to that of Deloitte; they also suggested that an amendment to the Standards or the issuance of an Interpretation would be more appropriate than an agenda decision. Furthermore, the ASCG said that even though an amendment or an Interpretation might also lead to an entity changing its accounting policy, such a change would not lead to the entity concluding that its previous practice was erroneous according to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. The ASCG said that such a conclusion could lead to unintended consequences for a preparer and its auditor—something that they stated it is neither warranted nor appropriate. The ASCG also said that they ‘disagree with the conclusion that IAS 39 is sufficiently clear’. In their view, the diversity in practice suggests that the Standard ‘has obviously been interpreted and applied in different ways’.
- (c) the Accounting Standards Board of Canada (AcSB)³ agreed with the Interpretations Committee’s decision not to add this item to its agenda for the observations stated in the tentative agenda decision. However, the AcSB also recommended that the last two sentences of bullet point (b) in the tentative agenda decision be deleted. This is because they think that ‘fees and points paid or received between the parties to the contract’ may also be considered to be incremental costs incurred to carry out the exchange or modification of the financial liability. Hence, the AcSB said the distinction between those ‘fees and points paid or received between the parties to the contract’ and ‘transaction costs’ is not helpful.

³ The views expressed in the comment letter received from the AcSB take into account comments from individual members of the AcSB staff.

Staff analysis of comment letters

8. As highlighted above, none of the respondents disagreed with the technical conclusion reached in the tentative agenda decision. However, two respondents suggested that the most appropriate way to provide the clarification requested in the submission would be either by making an amendment to the Standards or by issuing an Interpretation. Of the suggested options, the staff think that an IFRIC Interpretation would be the most appropriate because it would provide the necessary clarity about the requirements in the Standards. However the staff think that the Interpretations Committee could also provide constituents with the same degree of clarity in a more cost-effective manner through an agenda decision. Our reasoning is outlined in the following paragraphs.
9. Paragraph 5.16 of the *Due Process Handbook* states (*emphasis added*):
- [...] The Interpretations Committee should address issues:
- (a) that have *widespread effect* and have, or are expected to have, a *material effect* on those affected;
 - (b) where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods; and
 - (c) that can be resolved efficiently within the confines of existing IFRSs and the Conceptual Framework for Financial Reporting.
10. In addition, paragraph 5.17 of the *Due Process Handbook* states that the Interpretations Committee should also consider whether addressing the issue is cost-effective (*emphasis added*):
- The issue should be sufficiently narrow in scope that it can be addressed in an efficient manner by the Interpretations Committee, *but not so narrow that it is not cost-effective for the Interpretations Committee and interested parties to undertake the due process* that would be required when making changes to IFRSs.
11. When assessing the nature of the issue submitted against the criteria stated above in the *Due Process Handbook*, the staff note that our outreach indicated that there is currently diversity in practice. Therefore, clarifying that the Standards distinguish fees paid or received between the parties to the contract from costs that are directly

attributable to the exchange or modification and how this distinction is relevant for an entity when deciding on which fees to include in the ‘10 per cent’ test would be useful to reduce this diversity.

12. However, our outreach also identified that some respondents thought that, in most cases, the inclusion of fees paid to third parties would not affect the outcome of the ‘10 per cent’ test. (These respondents included two accounting firms, entities in the banking sector submitting their feedback to a European national standard-setter and a national standard-setter based in Asia.) One accounting firm and an Asian national standard-setter did not consider the ‘10 per cent’ test itself to be a dominant factor in the assessment of whether a financial liability has been substantially modified and, consequently, is derecognised. Only one European standard-setter stated that the outcome of the ‘10 per cent’ test is often directly dependent on whether or not third-party fees are included.
13. Consequently, the staff think that although the technical conclusion in the tentative agenda decision has not been questioned, on the basis of the comment letters received and the criteria in the *Due Process Handbook*, the key matter to be considered is what would be the most cost-effective manner to provide this clarification.
14. On the basis of the feedback received in the outreach, the staff think that in most cases this issue does not have a material effect on entities—ie the inclusion of third-party fees would not affect the outcome of the test in most cases. Therefore, the staff continue to think that issuing an Interpretation or an amendment to the Standards would not necessarily be the most cost-effective way for the Interpretations Committee to clarify this issue. The staff think that the agenda decision identifies the key principles in the Standard underlying the ‘10 per cent’ test and that, consequently, it should provide sufficient clarity to help reduce the current diversity in practice.

Staff recommendation

15. The staff have addressed the drafting comments received (as described in paragraph 7(c) above) and reflected other editorial changes as a mark-up to the published tentative agenda decision in Appendix A to this paper.

16. On the basis of our analysis, we recommend confirming the tentative agenda decision as published in the IFRIC Update in May 2016. Appendix A of this paper sets out the draft wording for the final tentative agenda decision.

Question for the Interpretations Committee

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Does the Interpretations Committee agree with the staff recommendation to finalise the agenda decision set out in Appendix A of this paper?

Appendix A—Agenda decision

A1. The staff propose the following amendments to the wording of the published tentative agenda decision.

IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement*—Fees and costs included in the ‘10 per cent’ test for the purpose of derecognition

The Interpretations Committee received a request to clarify the requirements in ~~IFRSAS 39~~ and ~~IFRAS 39~~ relating to which fees and costs should be included in the ‘10 per cent’ test for the purpose of derecognition of a financial liability.

The Interpretations Committee observed the following:

- (a) paragraphs ~~B3.3.6 of IFRS 9 and~~ AG62 of IAS 39 ~~and B3.3.6 of IFRS 9~~ require an entity to include ‘any fees paid net of any fees received’ in the ‘10 per cent’ test when assessing whether the terms of an exchange or a modification of a financial liability are substantially different and lead to the derecognition of the original financial liability. Those paragraphs also include requirements regarding how to account for ‘any costs or fees incurred’ relating to the exchange or modification depending on whether that exchange or modification led to the derecognition of the financial liability
- (b) in considering the items to include in the calculation of the effective interest rate, ~~IFRSAS 39 and IFRAS 39~~ distinguish between ‘fees and points paid or received between the parties to the contract’ and ‘transaction costs’. The Interpretations Committee noted that the objective of the ‘10 per cent’ test is to quantitatively assess the significance of any difference between the old and new contractual terms by analysing the effect of the changes in the contractual cash flows (ie the contractual cash flows between the lender and the borrower). Consequently, the ‘fees’ included in the ‘10 per cent’ test are similar to the ‘fees and points paid or received between the parties to the contract’ included in the calculation of the effective interest rate in that they represent contractual cash flows between the lender and the borrower. In contrast, ‘any costs or fees’ incurred relating to an exchange or a modification have a similar nature to ‘transaction costs’ in that they are ~~incremental~~ costs directly attributable to the exchange or modification: ~~(ie ¶those costs or fees would not have been incurred if the entity had not exchanged or modified the financial liability).~~

On the basis of these observations, the Interpretations Committee noted that, when applying paragraphs ~~B3.3.6 of IFRS 9 and~~ AG62 of IAS 39 ~~and B3.3.6 of IFRS 9~~ in carrying out the ‘10 per cent’ test, an entity includes only fees paid or received between the lender and the borrower or fees paid by, ~~or on behalf of,~~ the lender or the borrower on its behalf.

In the light of the existing requirements in IFRS Standards, the Interpretations Committee determined that neither an Interpretation nor an amendment to a Standard was necessary. Consequently, the Interpretations Committee ~~[decided]~~ not to add this issue to its agenda.

Appendix B



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

22 July 2016

Dear Mr Upton

Tentative agenda decision – IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement*: Fees and costs included in the '10 per cent' test for the purposes of derecognition

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the May IFRIC Update of the tentative decision not to take onto the Committee's agenda the issue of which fees and costs should be included in the '10 per cent' test for the purposes of derecognition of a financial liability.

Whilst we agree with the IFRS Interpretations Committee's position that, conceptually, the most appropriate approach is to include only fees paid or received between the lender and the borrower, we are not convinced that the guidance cited in the tentative agenda decision is sufficient to preclude a broader interpretation. We believe that a more significant clarification of the standard is warranted as well as, since there is currently significant diversity, explicit transition provisions. As such, we believe that the issue would be better addressed by an amendment to IFRS 9 and IAS 39 as part of the Annual Improvements project or, if considered too significant for that project, via a formal interpretation.

As a point of detail, we also note that the reference to "fees paid by, or on behalf of, the lender or the borrower" in the tentative agenda decision is currently ambiguous as it could be read as referring to any fee paid by either party. If the intention of this reference is to include fees paid by one party on behalf of the other (so, in substance, a payment from the borrower to the lender or vice versa) this should be stated more clearly.

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

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Deloitte.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'V. Poole', written in a cursive style.

Veronica Poole
Global IFRS Leader

July 22, 2016

By e-mail to ifric@ifrs.org

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

Dear Sirs:

Re: Tentative agenda decision on IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement*—Fees and costs included in the ‘10 per cent’ test for the purpose of 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 which fees and costs should be included in the ‘10 per cent’ test for the purpose of derecognition of a financial liability. This tentative agenda decision was published in the May 2016 IFRIC Update.

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

We agree with the Committee’s decision not to add this item to its agenda because we agree with the observations in the tentative agenda decision. However, we think the following two sentences from the tentative agenda decision should be removed as they are confusing and unnecessary:

“In contrast, ‘any costs or fees’ incurred relating to an exchange or a modification have a similar nature to ‘transaction costs’ in that they are incremental costs directly attributable to the exchange or modification. Those costs or fees would not have been incurred if the entity had not exchanged or modified the financial liability.”

July 22, 2016

We think that 'fees and points paid or received between the parties to the contract' and 'transaction costs' are not mutually exclusive in all respects. Specifically, 'fees and points paid or received between parties to the contract' might also be considered incremental costs that were incurred to carry out the exchange or modification of the financial liability. For this reason, we think that this contrast is not helpful and may in fact be confusing.

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,



Rebecca Villmann, CPA, CA
CPA (Illinois)
Director, Accounting Standards



IFRS 9 / IAS 39 – Fees/cost included in 10 per cent test for derecognition

We do not agree with the tentative decision, and our concern is more one of process than of substance. The IFRS IC's conclusion effectively leads to an interpretation of how IAS 39.AG62 and IFRS 9.B3.3.6 should (have) be(en) read and applied – without issuing an interpretation though. Given diversity in practice that led to the submission to the IFRS IC in the first place, IAS 39 has obviously been interpreted and applied in different ways.

We disagree with the IFRS IC's conclusion that the standard is (and has always been) sufficiently clear and that there is only one way of reading IAS 39. (If this were the case, a different reading of the standard that has so far been deemed appropriate, but that is now deemed erroneous, would lead to potential restatements of prior periods).

We believe that setting GAAP by means of an agenda decision is inappropriate in this regard and urge the IFRS IC to reconsider its process as follows: If the IFRS IC wanted to reduce diversity in practice and enhance consistent application, it should do so by issuing an interpretation or by amending the standard(s). Whilst this would also lead to a change in accounting policies, it would not deem prior practice erroneous per IAS 8, which could lead to unintended consequences for the preparer and its auditor – something we feel is neither warranted nor appropriate.

