

## STAFF PAPER

July 2017

## IASB Meeting

<b>Project</b>	<b>Prepayment Features with Negative Compensation</b>		
<b>Paper topic</b>	Effective date and transition provisions		
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**Objective and scope**

1. This paper discusses the proposals in the Exposure Draft *Prepayment Features with Negative Compensation* (proposed amendments to IFRS 9) (the ED) related to effective date and transition and sets out our recommendations on finalising those issues.
2. Related to transition, there are three topics to consider:
  - (a) retrospective application of the amendments;
  - (b) the specific transition provision proposed in the ED that specifies how an entity would apply the second eligibility condition (ie the assessment of the fair value of the prepayment feature at the initial recognition of the financial asset) when the entity first applies the amendments; and
  - (c) additional transition provisions that may be necessary if the Board decides that the effective date of the amendments will be later than the effective date of IFRS 9, ie whether an entity would apply some of the transition provisions in Section 7.2 of IFRS 9 again when it applies the amendments.
3. The topics described in paragraphs 2(a) and 2(c) are discussed in this paper. However, the topic described in paragraph 2(b) will depend on the Board's decision on the second eligibility condition and therefore is discussed in Agenda Paper 3A (including the related proposed consequential amendments to IFRS 7

*Financial Statements: Disclosure and IFRS 1 First-time Adoption of International Financial Reporting Standards*).

4. This paper:
  - (a) sets out the staff recommendations (paragraphs 5—6);
  - (b) discusses the proposals in the ED, feedback received and staff analysis on the *effective date* (paragraphs 7—13); and
  - (c) discusses the proposals in the ED, feedback received and staff analysis on *transition* (paragraphs 14—24).

### **Staff recommendation**

5. The staff recommend that the amendments are mandatorily effective for annual periods beginning on or after 1 January 2019 to allow sufficient time for endorsement and/or translation processes. We recommend that earlier application is permitted.
6. The staff recommend that the amendments are applied retrospectively. However, we think the effective date recommended in paragraph 5 has consequences for transition. In that regard, the staff recommend that if an entity applies the amendments for the first time after it applies IFRS 9 then the entity:
  - (a) would apply the relevant transition provisions in Section 7.2 of IFRS 9 to financial assets that are affected by the amendments and, in the case of designation and de-designation under the fair value option (FVO), to any related financial liabilities (paragraph 19—22);
  - (b) would not be required to restate prior periods to reflect the amendments, and could choose to do so only if it is possible without the use of hindsight (paragraph 23); and
  - (c) would be required to provide particular transition disclosures (paragraph 24).

## Effective date

### *Proposed effective date*

7. The Board proposed that the effective date of the amendments would be annual periods beginning on or after 1 January 2018 with earlier application permitted. That proposal would align the effective date of the amendments with the effective date of IFRS 9. As discussed in paragraph BC25 of the Basis for Conclusions on the ED, the Board thinks there would be significant benefits if entities initially apply IFRS 9 taking into account the effect of the proposed amendments.
8. At the same time, as discussed in paragraph BC26 of the Basis for Conclusions on the ED, the Board acknowledged that many entities are advanced in their implementation of IFRS 9 and may not have sufficient time before the effective date of IFRS 9 to determine the effect of the proposed amendments. Additionally, the Board was aware that some jurisdictions will need time for translation and endorsement activities and the proposed effective date may not provide sufficient time. Therefore, the Board asked in the ED whether a later effective date, with earlier application permitted, would be more appropriate.

### *Feedback received*

9. As discussed in more detail in Agenda Paper 3A for the June 2017 Board meeting, respondents had mixed views about the proposed effective date. More than half of the respondents agreed that the effective date of the amendments should be the same as the effective date of IFRS 9; that is, annual periods beginning on or after 1 January 2018. These respondents generally agreed with the Board's rationale set out in the Basis for Conclusions on the ED.
10. In contrast, others said they prefer a later effective date for the amendments; specifically, annual periods beginning on or after 1 January 2019 (with earlier application permitted) because this would allow jurisdictions with translation and/or endorsement processes for IFRS Standards to finalise such activities before the mandatory effective date.

**Staff analysis and recommendation**

11. The staff continues to believe that there are significant benefits if entities initially apply IFRS 9 taking into account the effect of the amendments. As noted in the Basis of Conclusions on the ED, it would be inefficient and burdensome for entities to initially apply IFRS 9 without these amendments and then be required to change the classification and measurement of some prepayable financial assets when they apply the amendments at a later date.
12. However, we understand the concerns raised by some respondents about the short period of time between the expected date of issuing the amendments and an effective date of annual periods beginning on or after 1 January 2018. We acknowledge that it might be difficult for entities in some jurisdictions, particularly those in jurisdictions with endorsement and/or translation process for IFRS Standards, to apply the amendments from that date. In some cases, this could lead to inefficiencies if an entity needs to prepare their financial statements using both IFRS Standards as issued by the Board and IFRS Standards as endorsed by their jurisdictional authority.
13. Therefore, on balance, the staff recommend that the amendments are effective for annual periods beginning on or after 1 January 2019 with earlier application permitted. The staff believe this would alleviate the concerns expressed by some respondents about the timing of these amendments. At the same time, permitting earlier application would mean that entities could apply these amendments and IFRS 9 at the same time if they are in a position to do so.

**Transition****Proposed transition requirements**

14. The Board proposed that the amendments would be applied retrospectively.
15. The Board did not propose any specific transition provisions for entities that apply IFRS 9 before they apply the amendments but asked for feedback on whether there are any additional transition considerations that need to be specifically addressed for those entities.

**Feedback received**

16. Nearly all respondents who answered this question agreed with the proposal to apply the amendments retrospectively.
17. Some respondents who supported an effective date later than annual periods beginning on or after 1 January 2018 said that any relevant transition provisions in Section 7.2 of IFRS 9 should be available again when an entity first applies the amendments. Some respondents specifically mentioned the provisions related to the FVO, applying the effective interest method and impairment, as well as the relief from restating prior periods.

**Staff analysis and recommendation on transition provisions***Transition requirements based on an effective date of 1 January 2018*

18. If the Board sets an effective date of annual periods beginning on or after 1 January 2018 as proposed in the ED, then we think the Board should reaffirm the proposal to require retrospective application of the amendments. We think there are no other transition provisions needed, apart from the transition provision proposed in the ED that specifies how an entity would apply the second eligibility condition, which is discussed separately in Agenda Paper 3A (see paragraphs 2(b) and 3 of this paper).

*Transition requirements based on an effective date of 1 January 2019*

19. If the Board sets an effective date of annual periods beginning on or after 1 January 2019, then we think the Board should still reaffirm the proposal to require retrospective application of the amendments. However, we considered whether there would be a need to provide additional transition provisions for entities applying the amendments for the first time after they apply IFRS 9. We think such transition provisions would be required for the following reasons:

- (a) The transition provisions in IFRS 9 would not be applicable when the entity applies the amendments because those paragraphs apply only at the relevant date(s) of initial application of IFRS 9. Therefore, if the amendments did not include any specific transition requirements for such entities, then those entities would apply the amendments

retrospectively subject to the requirements for changes in accounting policies in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. In some circumstances, it may not be possible for an entity to apply the amendments retrospectively without the use of hindsight.

- (b) In addition, when the Board developed the transition requirements in IFRS 9, it provided specific requirements to address scenarios when it would be impracticable to apply particular requirements retrospectively.

20. We think the Board should provide similar transition requirements for the amendments. That is, if the Board sets the effective date as annual periods beginning on or after 1 January 2019, then we think an entity should apply the relevant transition provisions in IFRS 9 that are necessary to apply those amendments.
21. For example, we think the transition provisions in paragraph 7.2.11 (related to applying the effective interest method) and paragraphs 7.2.17—7.2.20 (related to applying the impairment requirements) should be available to a financial asset that is newly measured at amortised cost or fair value through other comprehensive income (FVOCI) as a result of applying the amendments. In addition, we think the transition provision in paragraph 7.2.3 (related to the assessment of the business model) could also be relevant in some cases. That is, we think the entity would need to assess the business model for financial assets that would be newly measured at amortised cost or FVOCI as a result of applying the amendments, on the basis of the facts and circumstances that exist at the date the entity first applies those amendments *if* an entity had not performed that assessment at the date of initial application of IFRS 9.<sup>1</sup> However, if an entity had performed the business model assessment for those assets at the date of initial application of IFRS 9, then we think reassessment is unnecessary and could be unduly burdensome. That is because, in such cases, an entity will have performed a thorough and robust assessment of the business model as part of its implementation of IFRS 9, and it is

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<sup>1</sup> This may be the case if, at the date of initial application of IFRS 9, an entity had determined that a financial asset would be measured at fair value through profit or loss on the basis of the asset's contractual cash flow characteristics and therefore the entity did not assess the business model at that date (ie because it would not have affected the classification outcome).

unlikely that the outcome of the assessment will be different at the date that the entity first applies the amendments. There is only a year between the effective date of IFRS 9 and (the staff's recommended) effective date of the amendments and the amendments do not affect the business model condition or the assessment thereof.

22. As a final example, we think the transition related to the FVO would be relevant. That is, we think an entity should be permitted to newly designate, and should be required to revoke its previous designation of, a financial asset or a financial liability at the date the entity first applies the amendments only to the extent that a new accounting mismatch is created, or a previous accounting mismatch no longer exists, as a result of applying the amendments. We note that this provision is similar to paragraph 7.2.28 of IFRS 9, which sets out the transition related to the FVO when an entity applies the limited amendments to the classification and measurement requirements for financial assets (issued in 2014) after previously applying an earlier version of IFRS 9.

### ***Staff analysis and recommendation on restatement of comparatives and disclosures***

#### *No requirement to restate comparative information*

23. We recommend that an entity would not be required to restate prior periods to reflect the effect of the amendments, and could choose to do so only if it is possible without the use of hindsight. This is consistent with the transition requirements in IFRS 9, and also with the transition requirements in IFRS 17 *Insurance Contracts* related to the redesignations and reassessments of particular financial assets at the date of initial application of that IFRS Standard.

#### *Disclosures*

24. We recommend that the Board require some disclosures that would provide information to users of financial statements about changes in the classification and measurement of financial instruments as a result of applying the amendments. These disclosures are similar to some of the disclosures required when an entity applies IFRS 9, in particular when it applies the limited amendments to the classification and measurement requirements for financial assets (issued in 2014)

after previously applying an earlier version of IFRS 9, and are also similar to the disclosures required by IFRS 17 related to the redesignations and reassessments of particular financial assets at the date of initial application of that IFRS Standard. Specifically, in the reporting period that an entity first applies the amendments, we recommend the entity is required to disclose the following information for each class of financial assets and financial liabilities as at the date that the entity first applies the amendments:

- (a) the previous measurement category and carrying amount determined in accordance with IFRS 9 (without taking into account the effect of the amendments);
- (b) the new measurement category and carrying amount determined in accordance with the amendments;
- (c) the carrying amount of any financial assets and financial liabilities in the statement of financial position that were previously designated under the FVO but are no longer so designated; and
- (d) the reasons for any designation or de-designation of financial assets or financial liabilities under the FVO.

## Questions for the Board

### Questions for the Board

1. Does the Board agree with the staff recommendation to set the effective date of the amendments as annual periods beginning on or after 1 January 2019, with earlier application permitted?
2. Does the Board agree with the staff recommendation to reaffirm the proposal to require retrospective application of the amendments?
3. If the Board agrees with the staff recommendation in Question 1, does the Board agree with the following staff recommendations:
  - (a) the entity would apply the relevant transition provisions in Section 7.2 of IFRS 9 to financial assets that are affected by the amendments and, in the case of designation and de-designation under the FVO, to any related financial liabilities;
  - (b) the entity would not be required to restate prior periods to reflect the amendments, and could choose to do so only if it is possible without the use of hindsight; and
  - (c) the entity would be required to provide the transition disclosures set out in paragraph 24 when it applies the amendments for the first time.