

Derecognition of financial instruments upon modification (IAS 39 *Financial Instruments: Recognition and Measurement*)—September 2012

The Interpretations Committee received a request for guidance on the circumstances in which the restructuring of Greek government bonds (GGB) should result in derecognition in accordance with IAS 39 of the whole asset or only part of it. In particular, the Interpretations Committee has been requested to consider whether:

- the portion of the old GGBs that are exchanged for twenty new bonds with different maturities and interest rates should be derecognised, or conversely accounted for as a modification or transfer that would not require derecognition?
- IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* would be applicable in analysing the submitted fact pattern?
- either paragraphs AG8 or AG62 of IAS 39 [now replaced by paragraphs B5.4.6 and B3.3.6 of IFRS 9 respectively] would be applicable to the fact pattern submitted if the GGBs were not derecognised?

Exchange of financial instruments: derecognition?

The Interpretations Committee noted that the request has been made within the context of a narrow fact pattern. The narrow fact pattern highlights the diversity in views that has arisen in relation to the accounting for the portion of the old GGBs that is exchanged for twenty new bonds with different maturities and interest rates. The submitter asked the Interpretations Committee to consider whether these should be derecognised, or conversely accounted for as a modification or transfer that would not require derecognition.

In addition, the Interpretations Committee has been asked to consider whether IAS 8 would be applicable in analysing the submitted fact pattern, and whether the exchange can be considered to be a transfer within the scope of paragraph 17(b) of IAS 39 [now replaced by paragraph 3.2.3(b) of IFRS 9].

The Interpretations Committee observed that the term ‘transfer’ is not defined in IAS 39. However, the potentially relevant portion of paragraph 18 of IAS 39 [now replaced by paragraph 3.2.4 of IFRS 9] states that an entity transfers a financial asset if it transfers the contractual rights to receive the cash flows of the financial asset. The Interpretations Committee noted that, in the fact pattern submitted, the bonds are transferred back to the issuer rather than being transferred to a third party. Accordingly, the Interpretations Committee believed that the transaction should be assessed against paragraph 17(a) of IAS 39 [now replaced by paragraph 3.2.3(a) of IFRS 9].

In applying paragraph 17(a), the Interpretations Committee noted that, in order to determine whether the financial asset is extinguished, it is necessary to assess the changes made as part of the bond exchange against the notion of ‘expiry’ of the rights to the cash flows. The Interpretations Committee also noted that, if an entity applies IAS 8 because of the absence in IAS 39 of an explicit discussion of when a modification of a financial asset results in derecognition, applying IAS 8 requires judgement to develop and apply an accounting policy. Paragraph 11 of IAS 8 requires that, in determining an appropriate accounting policy, consideration must first be given to the requirements in IFRSs that deal with similar and related issues. The Interpretations Committee noted that, in the fact pattern submitted, that requirement would lead to the development of an analogy to the notion of a substantial change of the terms of a financial liability in paragraph 40 of IAS 39 [now replaced by paragraph 3.3.2 of IFRS 9].

Paragraph 40 sets out that such a change can be effected by the exchange of debt instruments or by modification of the terms of an existing instrument. Hence, if this analogy to financial liabilities is applied to financial assets, a substantial change of terms (whether effected by exchange or by modification) would result in derecognition of the financial asset.

The Interpretations Committee noted that, if the guidance for financial liabilities is applied by analogy to assess whether the exchange of a portion of the old GGBs for twenty new bonds is a substantial change of the terms of the financial asset, the assessment needs to be made taking into consideration all of the changes made as part of the bond exchange.

In the fact pattern submitted, the relevant facts led the Interpretations Committee to conclude that, in determining whether the transaction results in the derecognition of the financial asset, both approaches (ie extinguishment under paragraph 17(a) of IAS 39 or substantial change of the terms of the asset) would result in derecognition.

The Interpretations Committee considered the following aspects of the fact pattern in assessing the extent of the change that results from the transaction:

- A holder of a single bond has received, in exchange for one portion of the old bond, twenty bonds with different maturities and cash flow profiles as well as other instruments in accordance with the terms and conditions of the exchange transaction.
- All of the bond-holders received the same restructuring deal irrespective of the terms and conditions of their individual holdings. This indicates that the individual instruments, terms and conditions were not taken into account. The different bonds (series) were not each modified in contemplation of their respective terms and conditions but were instead replaced by a new uniform debt structure.
- The terms and conditions of the new bonds are substantially different from those of the old bonds.

The changes include many different aspects, such as the change in governing law; the introduction of contractual collective action clauses and the introduction of a co-financing agreement that affects the rights of the new bond holders; and modifications to the amount, term and coupons.

The Interpretations Committee noted that the starting point that it used for its analysis was the assumption in the submission that the part of the principal amount of the old GGBs that was exchanged for new GGBs could be separately assessed for derecognition. The Interpretations Committee emphasised that this assumption was more favourable for achieving partial derecognition than looking at the whole of the old bond. Hence, its conclusion that the old GGBs should be derecognised would apply even more so when taking into account that the exchange of the old GGBs was, as a matter of fact, the result of a single agreement that covered all aspects and types of consideration for surrendering the old GGBs. As a consequence, the Interpretations Committee noted that partial derecognition did not apply.

Consequently, the Interpretations Committee decided not to add the issue to its agenda.

Application of paragraphs AG62 or AG8 of IAS 39 to the submitted fact pattern

The Interpretations Committee noted that the questions raised by the submitter assume that the old GGBs in the fact pattern would not be derecognised. In the submitted fact pattern, the Interpretations Committee concluded that the old GGBs are derecognised. The Interpretations Committee noted that, because of its conclusion on derecognition, these questions did not need to be answered.