

## STAFF PAPER

November 2012

## IFRS Interpretations Committee Meeting

<b>Project</b>	<b>Review of comments received on agenda decision</b>		
<b>Paper topic</b>	<b>IAS 39 <i>Financial Instruments: Recognition and Measurement</i>—Accounting for different aspects of restructuring Greek Government Bonds</b>		
CONTACT(S)	Christopher Bittel	<a href="mailto:cbittel@ifrs.org">cbittel@ifrs.org</a>	+44 (0)20 7246 6953
	Manuel Kapsis	<a href="mailto:mkapsis@ifrs.org">mkapsis@ifrs.org</a>	+44 (0)20 7246 6411

This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in *IFRIC Update*. The approval of a final Interpretation by the Board is reported in *IASB Update*.

## Introduction

1. In April 2012, the IFRS Interpretations Committee received a request for guidance on several accounting issues that resulted from the restructuring of Greek government bonds (GGBs) in 2012. At its September 2012 meeting, the Interpretations Committee concluded that the GGBs surrendered in March 2012 should be derecognised, which means the new GGBs received as part of the debt restructuring are recognised as new assets.
2. At the July 2012 meeting, the Interpretations Committee addressed the particular request to consider whether paragraph AG5 of IAS 39 *Financial Instruments: Recognition and Measurement* could apply when determining the effective interest rate on initial recognition of those new GGBs (see July 2012 Agenda Paper 6). The Interpretations Committee concluded that paragraph AG5 applies to acquired assets, which includes both purchased and originated assets. The Interpretations Committee considered that in the light of its analysis of the existing requirements of IAS 39 an interpretation was not necessary and tentatively decided not to add the issue to its agenda.

## Comment letter summary

3. The comment period for the tentative agenda decision ended on 17 September 2012 and three responses were received. Two of them agreed with the Interpretations Committee's decision not to add this item to its agenda for the reasons provided in the tentative agenda decision.
4. The other respondent agreed with the tentative agenda decision but requested some amendments to improve the wording. In addition to commenting on the tentative agenda decision, that respondent requested the Interpretations Committee recommend that the IASB give further consideration to the following issues as part of its project to replace IAS 39:
  - (a) Whether there is a need for additional guidance on how facts and circumstances should be analysed in order to assess the most appropriate accounting treatment to enhance consistent application in practice;
  - (b) Whether the IASB could better articulate the interaction between the recognition of assets within the scope of paragraph AG5 and the application of impairment requirements to other assets for further clarity; and
  - (c) Clarifying the application of paragraph AG5 to an asset classified as available for sale.

## Analysis of issues raised

### *Drafting concerns*

5. One response expressed concerns that, as drafted, the tentative agenda decision might be interpreted as limiting the application of paragraph AG5 of IAS 39 to originations resulting from transactions that were forced upon existing lenders. In the staff's view the fact pattern presented in the tentative agenda decision is clearly labelled as an *example* and in particular, an example of how an asset could arise that was credit impaired on origination (as opposed to the more common occurrence as a purchase). Consequently, the circumstances leading to the

recognition of an asset with an incurred loss on initial recognition need not be limited to those in which debt instruments are effectively forced upon existing lenders, but could also arise in other transactions.

6. The staff have suggested an amendment to the wording of the agenda decision to reflect this view, but have retained the fact pattern the Interpretations Committee explored that gave rise to assets that were impaired on origination to illustrate an example of when this may occur.

*Further guidance in project to replace IAS 39*

7. One respondent requested additional guidance for whether an asset is ‘credit impaired’ on initial recognition and suggested that the IASB considers this as part of its project to replace IAS 39. The respondent noted that there is no homogenous understanding of when paragraph AG5 of IAS 39 is applied and believes that additional guidance is necessary to enhance consistent application in practice.
8. In July 2012 the IASB discussed the issue as part of the IASB project to replace IAS 39. At that meeting, the IASB tentatively decided that an entity shall include expected credit losses in the estimated cash flows when computing the effective interest rate for financial assets that have objective evidence of impairment on initial recognition (ie both originated and purchased financial assets).
9. The same respondent asked whether the application of AG5 to available-for-sale financial instruments means that changes in fair value should be recognised in profit or loss.
10. As part of phase 1 of its project to replace IAS 39, the IASB eliminated the available-for-sale classification, partly because of the difficulties arising from the impairment requirements for available-for-sale financial assets. The IASB is considering introducing a “fair value through other comprehensive income” classification for eligible debt instruments in its limited review of classification and measurement under IFRS 9. However, the IASB has tentatively decided that for assets classified as fair value through other comprehensive income an entity

will present amounts for interest revenue and impairment gains and losses in profit or loss calculated using the requirements for amortised cost. Given these proposals, the problems regarding accounting for available-for-sale assets will fall away.

### **Staff recommendation**

11. The staff recommend confirming the tentative agenda decision. The tentative agenda decision already provides guidance for IAS 39 on the impairment of originated and purchased assets with incurred losses on initial recognition.
12. Regarding the suggestion for the Interpretations Committee to recommend the IASB consider issues in its project to replace IAS 39, the staff note that the IASB has considered those issues already in coming to its conclusions in IFRS 9 or in the tentative decisions for the parts in development. The IASB is planning to publish an Exposure Draft on the above proposals which will provide the opportunity for further comments if necessary. In the light of the IASB's ongoing project on the replacement of IAS 39 the staff do not think the Interpretations Committee needs to take further action on the above.

### **Question to the Interpretations Committee**

#### **Question for the Interpretations Committee**

Does the Interpretations Committee agree with the proposed rejection wording in Appendix A?

## Appendix A—Proposed wording for final agenda decision

A1. The staff propose the following wording for the agenda decision:

### **IAS 39 *Financial Instruments: Recognition and Measurement*—Scope of paragraph AG5**

The IFRS Interpretations Committee received a request for guidance on several accounting issues that resulted from the restructuring of Greek government bonds (GGBs) in 2012. At its ~~May~~ September 2012 meeting, the Interpretations Committee ~~tentatively~~ concluded that the GGBs surrendered in March 2012 should be derecognised, which means the new GGBs received as part of the debt restructuring are recognised as new assets. At ~~this~~ the July 2012 and November 2012 meetings, the Interpretations Committee addressed the particular request to consider whether paragraph AG5 of IAS 39 could apply when determining the effective interest rate on initial recognition of those new GGBs. Applying paragraph AG5 of IAS 39 means that the effective interest rate would be determined at initial recognition using estimated cash flows that take into account incurred credit losses.

The Interpretations Committee noted that paragraph AG5 of IAS 39 applies to acquired assets, which includes both purchased and originated assets.

The Interpretations Committee also noted that even though an origination of a debt instrument with an incurred loss is rather unusual, there are situations in which such transactions occur. For example, in the context of significant financial difficulty of an obligor, transactions can arise that involve originations of debt instruments that are outside the normal underwriting process but instead forced upon already existing lenders by a restructuring process. This could include situations in which modifications of debt instruments result in derecognition of the original financial asset and the recognition of a new financial asset under IFRSs. In circumstances such as these, new financial assets could be recognised that have incurred losses on initial recognition. The Interpretations Committee noted that whether an incurred loss exists on initial recognition of an asset is a factual matter and that the assessment requires judgement. The Interpretations Committee also noted that the circumstances leading to the recognition of an asset with an incurred loss on initial recognition, need not be limited to those in which debt instruments are effectively forced upon existing lenders, but could also arise in other transactions.

The Interpretations Committee considered that in the light of its analysis of the existing requirements of IAS 39 an interpretation was not necessary and consequently {decided} not to add the issue to its agenda.

August 16, 2012

(via email to [ifric@ifrs.org](mailto:ifric@ifrs.org))

IFRS Interpretations Committee  
30 Cannon Street, 1st Floor  
London EC4M 6XH  
United Kingdom

Dear Sirs:

**IAS 39 Financial Instruments: Recognition and Measurement—Scope of paragraph AG5**

This letter is the response of the staff of the Canadian Accounting Standards Board (AcSB) to the IFRS Interpretations Committee's tentative agenda decision on accounting for different aspects of restructuring Greek Government Bonds published in the July 2012 IFRIC Update.

The views expressed in this letter take into account comments from individual members of the AcSB staff but do not necessarily represent a common view of the AcSB or its staff. Views of the AcSB are developed only through due process.

We agree with the Committee's decision not to add this item to its agenda for the reasons provided in the tentative agenda decision.

If you require further information, please contact me at +1 416 204-3276 (email [peter.martin@cica.ca](mailto:peter.martin@cica.ca)) or Kate Ward, Principal, Accounting Standards at +1 416 204-3437 (email [kate.ward@cica.ca](mailto:kate.ward@cica.ca)).

Regards



Peter Martin, CA  
Director, Accounting Standards

Mr Wayne Upton  
Chairman  
International Financial Reporting Interpretations Committee  
30 Cannon Street  
London  
United Kingdom  
EC4M 6XH

Email: ifric@ifrs.org

5 September 2012

Dear Mr Upton,

**Tentative agenda decision: IAS 39 Financial Instruments: Recognition and Measurement –  
Scope of paragraph AG5**

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretation Committee's publication in the July 2012 *IFRIC Update* of the tentative decision not to take onto the IFRIC's agenda a request for interpretation of whether paragraph AG5 of IAS 39 could apply when determining the effective interest rate on initial recognition of the new Greek government bonds (GGBs) received as part of the restructuring of GGBs in March 2012. Applying paragraph AG5 of IAS 39 means that the effective interest rate would be determined at initial recognition using estimated cash flows that take into account incurred credit losses.

We agree with the IFRS Interpretations Committee's decision not to add this item onto its agenda for the reasons set out in the tentative agenda decision.

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

**International Accounting  
Standards Board  
Mr Hans Hoogervorst**

**IFRS Interpretations  
Committee  
Mr Wayne Upton**

**30 Cannon Street  
London, EC4M 6XH L  
United Kingdom**

## **The IFRS Interpretations Committee's tentative agenda decision on IAS 39 Financial Instruments: *Recognition and Measurement* – Scope of para- graph AG5**

Dear Mr Hoogervorst,

Dear Mr Upton,

The European Securities and Markets Authority (ESMA) is an independent EU Authority that contributes to enhancing the protection of investors and promoting stable and well-functioning financial markets in the European Union (EU). ESMA achieves this aim by building a single rule book for EU financial markets and ensuring its consistent application across the EU. ESMA contributes to the regulation of financial services firms with a pan-European reach, either through direct supervision or through the active co-ordination of national supervisory activity.

ESMA has considered the IFRS Interpretations Committee's tentative decision to our request to clarify whether it is possible to apply paragraph AG5 of IAS 39 – *Financial Instruments: Recognition and Measurement* for the new bonds issued as part of the restructuring of Greek government bonds. ESMA welcomes the Committee's swift reaction and would like to provide you with the following considerations aimed at improving the decision-usefulness of financial statements and the transparency and enforceability of IFRSs.



We would like to suggest the Interpretations Committee to improve the wording of the rejection notice. We are concerned that the example used by the Committee in the rejection notice might be interpreted by some as paragraph AG5 would *only* apply if the transactions are *forced* upon already existing lenders. There are however investors (including, but not limited to, hedge funds) which acquire loan portfolios at a deep discount as part of their regular course of business. We believe that the IFRS Interpretations Committee should amend the wording in order not to create additional arguments for issuers willing to avoid the accounting treatment set out in paragraph AG5.

In addition we would like to suggest the Interpretations Committee to recommend the IASB to give further consideration as part of its project on IFRS 9 – *Financial Instruments* to some issues linked to the accounting of financial assets that are acquired at a deep discount reflecting incurred credit losses (financial assets with explicit expectation of loss at initial recognition), as explained hereafter. Indeed, some may suggest that there is no homogenous understanding of when paragraph AG5 of IAS 39 – *Financial Instruments: Recognition and Measurement* should be applied in the current IFRS literature.

Though we believe that whether paragraph AG5 should be applied requires judgement and depends on facts and circumstances, the IASB might want to consider whether there is a need for additional guidance in IFRS 9 on how facts and circumstances should be analysed in order to assess the most appropriate accounting treatment. For example it may want to identify if and why specific characteristics of a transaction should be given more weight than others in reaching a conclusion on the appropriate accounting treatment. Such guidance would help issuers to support their rationale and could enhance consistent application in practice.

In addition, we understand that it might not be sufficiently clear whether, in the case an entity applies paragraph AG5 to an available-for-sale asset originated at deep discount for which fair value declines over time, variations in the fair value of this instruments should be recognised in profit or loss or in “Other Comprehensive Income” under current IAS 39 (as already required for impaired available-for-sale assets). Some may consider that the acquisition at a deep discount could be considered objective evidence of impairment, even though paragraph 59 of IAS 39 states that the objective evidence of impairment should be the result of a loss event that occurred *after the initial recognition* of the instrument.

As part of its deliberations on IFRS 9, the IASB could better articulate the interaction between the recognition of the purchased/originated financial assets with explicit expectation of loss (currently referred to as assets acquired at deep discount in paragraph AG5 of IAS 39) and application of the impairment guidance to all categories of financial assets in order to bring further clarity.



We would be happy to discuss all or any of these issues further with you.

Yours sincerely,

A handwritten signature in blue ink, consisting of a stylized 'S' followed by a horizontal line and a small flourish.

Steven Maijoor  
ESMA Chair

A handwritten signature in blue ink, appearing to read "Julia Galbo" in a cursive style.

Julia Galbo  
Chair of ESMA's Corporate Reporting Standing Committee