STAFF PAPER

March 2017

IFRS® Interpretations Committee Meeting

| Project | Modifications and exchanges of financial liabilities |
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| Paper topic | Feedback from the Board |

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## Introduction and objective of the paper

1. The IFRS Interpretations Committee (the Committee) received a request regarding IFRS 9 *Financial Instruments*. The request asked the Committee to clarify whether an entity recognises a gain or loss in profit or loss when a financial liability is modified or exchanged and that modification or exchange does not result in the derecognition of the financial liability.

2. The Committee discussed the issue at its November 2016 meeting (see Agenda Paper 6). At that meeting, the Committee tentatively decided to develop a draft Interpretation, which would explain the accounting for such modifications and exchanges applying IFRS 9.

3. At its February 2017 Meeting, the International Accounting Standards Board (the Board) discussed the Committee's tentative decision to develop a draft Interpretation. At that meeting, the Board did not support the publication of a draft Interpretation.

4. The objective of this paper is to:
   (a) provide the Committee with an update of the Board's discussion; and
   (b) ask the Committee whether it agrees with the Board's recommendation to issue an educative agenda decision—ie an agenda decision that explains the accounting for the modifications and exchanges in question applying IFRS 9.

## Structure of the paper

5. The paper is organised as follows:

   (a) Background (paragraphs 7–10);

   (b) Board discussion (paragraphs 11–13); and

   (c) Board recommendation (paragraphs 14–15).

6. Appendix A outlines the proposed wording for a tentative agenda decision.

## Background

7. At its November 2016 meeting, the Committee discussed a submission relating to IFRS 9. The submitter asked whether, in applying IFRS 9, an entity recognises a gain or loss in profit or loss when a financial liability measured at amortised cost:

   (a) is modified or exchanged; and

   (b) that modification or exchange does not result in the derecognition of the financial liability.

8. The Committee concluded that the requirements in paragraph B5.4.6 of IFRS 9 apply to all revisions of estimated payments or receipts, including changes in cash flows arising from modifications and exchanges of financial liabilities that do not result in the derecognition of the financial liability. This conclusion is consistent with the definition of amortised cost in Appendix A of IFRS 9, and also the requirements in paragraph 5.4.3 of IFRS 9 relating to modifications of financial assets that do not result in derecognition.

9. Applying paragraph B5.4.6, an entity recalculates the amortised cost of the modified financial liability by discounting the modified contractual cash flows using the original effective interest rate. The entity recognises any adjustment to the amortised cost of the financial liability in profit or loss as income or expense at the date of the modification or exchange.

10. The Committee observed that the feedback from outreach activities on practice applying IAS 39 *Financial Instruments: Recognition and Measurement* indicated it

would be beneficial to clarify the accounting required by IFRS 9 for modifications or exchanges of financial liabilities that do not result in derecognition. In the light of those outreach responses (confirmed by Committee members' experience in practice), the majority of Committee members were concerned that many entities would be unaware of the conclusions reached by the Committee, and thus unaware that they may need to change their existing accounting for such modifications when they first apply IFRS 9. Consequently, the Committee tentatively decided to develop a draft Interpretation, which would explain the accounting for such modifications and exchanges.

## Board discussion

11. In accordance with paragraph 7.10 of the IFRS Foundation *Due Process Handbook*, the Board, at its February 2017 meeting, considered whether the proposed draft Interpretation should be published.

12. The Board agreed with the Committee's technical conclusions on the matter. However, it expressed concern about issuing a draft Interpretation in this situation. The Board concluded that the principles and requirements in IFRS 9 provide an adequate basis to enable an entity to account for modifications and exchanges of financial liabilities that do not result in derecognition. Accordingly, a draft Interpretation would have been used principally as a means of highlighting the accounting already required by IFRS 9. The Board concluded that, in this situation, standard-setting is not required. However, given the importance of the matter, other means should be used to highlight the relevant accounting.

13. Consequently, all 12 Board members objected to issuing a draft Interpretation.

## Board recommendation

14. The Board recommended that the Committee proceed with proposing an educative agenda decision on the matter, which would explain the accounting for modifications and exchanges of financial liabilities that do not result in derecognition applying

IFRS 9. The Board will also consider other ways to highlight this matter—for example within a webcast.

15. As a consequence, we have drafted a tentative agenda decision for the Committee's consideration, outlined in **Appendix A** to the paper.

| **Questions for the Committee** |
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| 1. Does the Committee agree with the Board recommendation to issue an educative agenda decision?<br><br>2. If the Committee agrees with the Board recommendation, does the Committee have any comments on the drafting of the tentative agenda decision outlined in Appendix A? |

## Appendix A—Tentative Agenda Decision

A1. The staff propose the following wording for the tentative agenda decision. The first three paragraphs below mirror those in IFRIC Update in November 2016, with one exception. In the first sentence of the first paragraph, we have added the words 'measured at amortised cost' to clarify that the financial liabilities in question are measured at amortised cost.

**IFRS 9 *Financial Instruments*—Modification or exchange of financial liabilities that do not result in derecognition**

The IFRS Interpretations Committee ('the Committee') received a request regarding the accounting for modifications or exchanges of financial liabilities measured at amortised cost that do not result in derecognition of the financial liability. More specifically, the request related to whether, applying IFRS 9, an entity recognises any adjustment to the amortised cost of the financial liability arising from such a modification or exchange in profit or loss at the date of the modification or exchange.

The Committee concluded that the requirements in paragraph B5.4.6 of IFRS 9 apply to all revisions of estimated payments or receipts, including changes in cash flows arising from modifications or exchanges of financial liabilities that do not result in derecognition of the financial liability. The Committee noted that this conclusion is consistent with the requirements in paragraph 5.4.3 of IFRS 9 relating to modifications of contractual cash flows of a financial asset that do not result in derecognition, and the definition of amortised cost in Appendix A of IFRS 9. In addition, in the case of a modification or exchange of a financial liability that does not result in derecognition, the financial liability continues to be accounted for as the same financial liability.

The Committee concluded that, applying paragraph B5.4.6 of IFRS 9 to such modifications or exchanges of financial liabilities, an entity recalculates the amortised cost of the modified financial liability by discounting the modified contractual cash flows using the original effective interest rate. The entity recognises any adjustment to the amortised cost of the financial liability in profit or loss as income or expense at the date of the modification or exchange.

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