



IFRS Alert

IASB issues Prepayment Features with Negative Compensation (Amendments to IFRS 9)

Issue 2017- 05

Executive summary

The International Accounting Standards Board (IASB) has published amendments to IFRS 9 'Financial Instruments' that allow companies to measure particular prepayable financial assets with negative compensation at amortised cost or at fair value through other comprehensive income—instead of measuring those assets at fair value through profit or loss.

The amendments also include clarifications to the modification or exchange of a financial liability that does not result in derecognition (see overleaf).

Background

After IFRS 9 was issued, the IFRS Interpretations Committee received a request on how to apply the IFRS 9 requirements for recognising and measuring financial instruments to certain debt instruments where the borrower is permitted to prepay the instrument at an amount that could be less than the unpaid principal and interest owed. Such a prepayment feature is often referred to as including potential 'negative compensation'.

Main issues addressed by the amendments to IFRS 9

Under the then existing requirements of IFRS 9, a company would have measured a financial asset with negative compensation at fair value through profit or loss as the 'negative compensation' feature would have been viewed as introducing potential cash flows that were not solely payments of principal and interest. However, to improve the usefulness of the information provided, in particular on the instrument's effective interest rate and expected credit losses, the Board issued 'Prepayment Features with Negative Compensation (Amendments to IFRS 9)'. The amendment means that entities will now be able to measure some prepayable financial assets with negative compensation at amortised cost.

The amendments are effective for annual periods beginning on or after 1 January 2019, with earlier application permitted.



Grant Thornton International Ltd comment

We welcome the publication of the amendment to IFRS 9. As stated in our comment letter on the preceding Exposure Draft, we believe that measurement at amortised cost or fair value through other comprehensive income is likely to provide more useful information on debt instruments with negative compensation clauses. In particular, information on the effective interest rate and expected credit losses seems more likely to be relevant to users in assessing performance for such debt instruments than recognising changes in their fair value through profit or loss.

continued overleaf



Another issue – modification or exchange of a financial liability that does not result in derecognition

Concurrent with the amendment to IFRS 9 for prepayment features with negative compensation, the IASB discussed the accounting for a modification or exchange of a financial liability measured at amortised cost that does not result in the derecognition of the financial liability. Specifically, the IASB considered whether, when applying IFRS 9, an entity should recognise 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 IASB concluded that no change needed to be made to the Standard itself but has clarified the existing position by adding text to the Basis for Conclusions on IFRS 9.

To summarise, IFRS 9 provides an adequate basis for an entity to account for modifications and exchanges of financial liabilities that do not result in derecognition. The text which has been added highlights that the requirements in IFRS 9 for adjusting the amortised cost of a financial liability when a modification (or exchange) does not result in the derecognition of the financial liability are consistent with the requirements for adjusting the gross carrying amount of a financial asset when a modification does not result in the derecognition of the financial asset. Those requirements state that when contractual cash flows of a financial asset are renegotiated or otherwise modified and the renegotiation or modification does not result in the derecognition of that financial asset, an entity shall recalculate the gross carrying amount of the financial asset and shall recognise a modification gain or loss in profit or loss.

The amendments to the Basis for Conclusions are effective for annual periods beginning on or after 1 January 2019, with earlier application permitted.



Grant Thornton International Ltd comment

Ironically, the ‘other amendment’ which has been included in the Basis for Conclusions and which ‘clarifies’ the accounting for a modification or exchange of a financial liability that does not result in derecognition may well result in the most significant change in accounting when the amendment is adopted.

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