Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Prepayment Features with Negative Compensation: Amendments to AASB 9**	**Meeting**	AASB December 2017 (M161)
Topic:	**Consider how to finalise ED 279**	**Agenda Item:**	4.2.0
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Objective of this paper

1 The objective of this paper is to seek the Board's decision as to how to finalise the Board's proposals exposed in AASB ED 279 *Prepayment Features with Negative Compensation*.

Attachments

Agenda Paper 4.2.1 Ballot Draft of Accounting Standard AASB 2017-Y *Amendments to Australian Accounting Standards – Prepayment Features with Negative Compensation*

Agenda Paper 4.2.2 RDR analysis of new disclosure requirements in AASB 2017-Y

Background

2 ED 279 incorporates IASB ED/2017/3 *Prepayment Features with Negative Compensation*, which proposed a narrow exception to IFRS 9 for particular financial assets that would otherwise have contractual cash flows that are solely payments of principal and interest but do not meet that condition only as a result of a prepayment feature. The proposals in IASB ED/2017/3 were finalised in IFRS *Prepayment Features with Negative Compensation*, issued by the IASB in October 2017. The IFRS amends IFRS 9 *Financial Instruments* to allow entities to measure particular prepayable financial assets with negative compensation at amortised cost or at fair value through other comprehensive income if certain conditions are met. The amendments apply to annual periods beginning on or after 1 January 2019, with earlier application permitted.

Summary of feedback received on the ED

3 The AASB has not received any comment letters on ED 279. However, the IASB received 60 comment letters[1] on ED/2017/3 from its world-wide constituents, including three submissions from Australia.

Addressing the concerns raised

4 Nearly all respondents supported the IASB's efforts to address the concerns raised about the classification of particular prepayable financial assets that may result in negative compensation. Respondents believe that such prepayable financial assets should be eligible for measurement at amortised cost or at fair value through other comprehensive income if the prepayment feature is the only reason for the asset not to meet the 'solely payments of principal and interest' condition. The eligibility for such measurement should not be affected only because the compensation amount is 'negative' rather than 'positive'.

Eligibility conditions

5 The ED proposed to permit particular prepayable financial assets to be measured at amortised cost or at fair value through other comprehensive income, subject to the assessment of the business model in which they are held, if two eligibility conditions are met:

(a) the prepayment amount is inconsistent with paragraph B.4.1.11(b) of IFRS 9 only because the party that chooses to terminate the contract early (or otherwise causes the early termination to occur) may receive reasonable additional compensation for doing so; and

(b) when the entity initially recognises the financial asset, the fair value of the prepayment feature is insignificant.

6 Many respondents supported both proposed eligibility conditions. However, many respondents expressed concern that the Basis for Conclusions on the ED seemed to interpret or provide additional guidance on the existing requirements in IFRS 9, particularly the meaning of 'reasonable compensation for the early termination of the contract'. These respondents argued that such notion already exists in paragraph B4.1.11(b) of IFRS 9 and hence interpretative guidance is unnecessary to achieve the objective.

7 While supported by some respondents, the second eligibility condition caused mixed views among many respondents, such as how difficult the condition would be to apply, whether it would restrict the scope of the amendments and whether it would achieve the Board's objective. More than half of the respondents disagreed with the second eligibility condition. Their view is that the first eligibility condition is sufficient and recommended to delete the second eligibility condition to avoid asymmetry.

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1 The comment letters are available on the IFRS Foundation's website at IFRS Prepayment-features-with-negative-compensation/comment-letters-projects/ed-prepayment-features-with-negative-compensation/.

Effective date

8 The proposed effective date, 1 January 2018, caused mixed feelings among some respondents. More than half of the respondents agreed with the proposed effective date of the amendments, being the same as the effective date of IFRS 9. However, the need for translation and/or endorsement processes could delay the application of the standard in some jurisdictions. Therefore, a later effective date, specifically annual periods beginning on or after 1 January 2019 (with early application permitted), was preferred.

Transition

9 Nearly all respondents agreed with retrospective application of the amendments subject to a specific transition provision, if doing so is impracticable. However, most of those respondents noted that the specific transition provision would be unnecessary if the second eligibility condition was removed.

Australian submissions to the IASB

10 Three of the comment letters received by the IASB on ED/2017/3 were from Australian constituents, being the AASB, ANZ Bank and National Australia Bank.

11 The comment letters expressed a common view that the amending standard should be finalised in time for the mandatory application of IFRS 9, i.e. 1 January 2018, and agreed with allowing subject financial instruments to be measured at amortised cost. The ANZ Bank's reason for a timely application of amendments was that it would be undesirable to measure subject financial instruments at fair value on the initial transition to IFRS 9 and later to revert to measurement at amortised cost. The AASB prioritised the urgency of proposed amendments over addressing the further concerns that the proposed amendments addressed accounting only of financial instruments that are originated and not those that might be acquired (either individually or through a business combination).

Decisions made by the IASB

12 In respect of the amendments to IFRS 9, the IASB decided:

(a) to clarify that the first eligibility condition in paragraph B4.1.11(b) covers reasonable negative compensation for the lender, by deleting the reference to "additional" compensation and adding a modified paragraph B4.1.12A, and decided to retain the explanation of its application in the Basis for Conclusions subject to some clarifications;

(b) not to include the second eligibility condition in the general case (paragraph B4.1.11(b)) so that an entity would not be required to assess the fair value of the prepayment feature at initial recognition;

(c) to align the existing exception in paragraph B4.1.12(b) of IFRS 9 with the amendments;

(d) to set the mandatory effective date as annual periods beginning on or after 1 January 2019 instead of the same date as IFRS 9 itself, but early application is permitted;

(e) to require retrospective application of the amendments using the relevant transition provisions in IFRS 9;

(f) not to require restatement of prior periods to reflect the amendments; and

(g) to require particular transition disclosures when an entity first applies the amendments.

RDR concessions

13 The IFRS amendments require disclosures by an entity that adopts IFRS 9 before it adopts these amendments (see paragraph 7.2.34). These disclosures were not included in IASB ED/2017/3 because the ED proposed an effective date for the amendments of annual periods beginning on or after 1 January 2018, the same as the effective date for IFRS 9.

14 The IASB Basis for Conclusions notes that these transition disclosures are similar to those in paragraphs 42I-42J of IFRS 7 *Financial Instruments: Disclosures*.

15 Agenda Paper 4.2.2 provides an RDR analysis comparing the transition disclosure requirements in paragraph 7.2.34 of IFRS 9 with the relevant disclosure requirements and RDR concessions in AASB 7.

16 Staff do not propose any RDR concessions because there are currently no concessions for the corresponding disclosures in AASB 7.

Staff recommendations

17 Overall, staff support the amendments made by the IASB. Staff are not aware that the proposed amendments would cause any significant issues for Australian entities.

18 Acknowledging the AASB submission and feedback received by the IASB from Australian constituents, staff recommend the AASB finalise the project by making an amending standard incorporating the IFRS *Prepayment Features with Negative Compensation* (Amendments to IFRS 9).

19 Staff do not consider that any not-for-profit (NFP) or public sector specific modification is needed as the amendments are clarifications to existing requirements that apply to both for-profit and not-for-profit entities. Staff have not identified any issue that warrants modifying the IFRS amendments for NFP or public sector entities.

20 Therefore, the staff recommend that Board members vote to make Accounting Standard AASB 2017-Y on the basis of the ballot draft provided as Agenda Paper 4.2.1. In accordance with our usual practice, the amendments to the IASB's Basis for Conclusions would be published on the AASB website as IASB supporting material, accessible only to website users in Australia (as per our copyright agreement with the IASB).

Question for Board members

Do Board members agree with the staff recommendation to issue an Amending Standard AASB 2017-Y incorporating IFRS *Prepayment Features with Negative Compensation* (Amendments to IFRS 9)?