ED/Ind AS/2018/05

Exposure Draft

Prepayment Features with Negative Compensation

(Amendments to Ind AS 109, *Financial Instruments)*

(Last date for Comments: 11th July, 2018)

Issued by

Accounting Standards Board

The Institute of Chartered Accountants of India

Exposure Draft

Prepayment Features with Negative Compensation

(Amendments to Ind AS 109, *Financial Instruments*)

Following is the Exposure Draft of Amendments to Ind AS 109, *Financial Instruments*, issued by the Accounting Standards Board of the Institute of Chartered Accountants of India for comments.

The Board invites comments on any aspect of this Exposure Draft. Comments are most helpful if they contain a clear rationale and, where applicable, provide suggestions for alternative wording.

Comments can be submitted using one of the following methods, so as to be received not later than **11th July, 2018**.

1. Electronically: Click on http://www.icai.org/comments/asb/ to submit comments online. (Preferred method)

2. Email: Comments can be sent to commentsasb@icai.in

3. Postal: Secretary, Accounting Standards Board, The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi – 110 002.

Further clarifications on any aspect of this Exposure Draft may be sought by e-mail to asb@icai.in.

Amendments to Ind AS 109, *Financial Instruments*

Paragraph 7.1.7 is added. A new heading and paragraphs 7.2.1–7.2.34 are added.

Chapter 7 Effective date and transition

7.1 Effective date

…

7.1.7 *Prepayment Features with Negative Compensation* (Amendments to Ind AS 109), added paragraphs 7.2.1–7.2.34 and B4.1.12A and amended paragraphs B4.1.11(b) and B4.1.12(b). An entity shall apply these amendments for annual periods beginning on or after 1 April, 2019. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact.

7.2 Transition[1]

7.2.1 An entity shall apply this Standard retrospectively, in accordance with Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, except as specified in paragraphs 7.2.4-7.2.14. This Standard shall not be applied to items that have already been derecognised at the date of initial application.

7.2.2 [Refer Appendix 1]

Transition for classification and measurement (Chapters 4 and 5)

7.2.3 At the date of initial application, an entity shall assess whether a financial asset meets the condition in paragraphs 4.1.2(a) or 4.1.2A(a) on the basis of the facts and circumstances that exist at that date. The resulting classification shall be applied retrospectively irrespective of the entity's business model in prior reporting periods.

7.2.4 If, at the date of initial application, it is impracticable (as defined in Ind AS 8) for an entity to assess a modified time value of money element in accordance with paragraphs B4.1.9B–B4.1.9D on the basis of the facts and circumstances that existed at the initial recognition of the financial asset, an entity shall assess the contractual cash flow characteristics of that financial asset on the basis of the facts and circumstances that existed at the initial recognition of the financial asset without taking into account the requirements related to the modification of the time value of money element in paragraphs B4.1.9B–B4.1.9D.

[1] Paragraphs 7.2.1-7.2.28 under the heading 'Transition' have been added as a consequence of issuance of *Prepayment Features with Negative Compensation* (Amendments to Ind AS 109), and Ind AS 117, *Insurance Contracts*. Accordingly, these transitional provisions can be considered only for the purpose of aforesaid amendments or where specifically mentioned.

7.2.5 If, at the date of initial application, it is impracticable (as defined in Ind AS 8) for an entity to assess whether the fair value of a prepayment feature was insignificant in accordance with paragraph B4.1.12(c) on the basis of the facts and circumstances that existed at the initial recognition of the financial asset, an entity shall assess the contractual cash flow characteristics of that financial asset on the basis of the facts and circumstances that existed at the initial recognition of the financial asset without taking into account the exception for prepayment features in paragraph B4.1.12.

7.2.6-7.2.7 [Refer Appendix 1]

7.2.8 At the date of initial application an entity may designate:

(a) a financial asset as measured at fair value through profit or loss in accordance with paragraph 4.1.5; or

(b) an investment in an equity instrument as at fair value through other comprehensive income in accordance with paragraph 5.7.5.

Such a designation shall be made on the basis of the facts and circumstances that exist at the date of initial application. That classification shall be applied retrospectively.

7.2.9 At the date of initial application an entity:

(a) shall revoke its previous designation of a financial asset as measured at fair value through profit or loss if that financial asset does not meet the condition in paragraph 4.1.5.

(b) may revoke its previous designation of a financial asset as measured at fair value through profit or loss if that financial asset meets the condition in paragraph 4.1.5.

Such a revocation shall be made on the basis of the facts and circumstances that exist at the date of initial application. That classification shall be applied retrospectively.

7.2.10 At the date of initial application, an entity:

(a) may designate a financial liability as measured at fair value through profit or loss in accordance with paragraph 4.2.2(a).

(b) shall revoke its previous designation of a financial liability as measured at fair value through profit or loss if such designation was made at initial recognition in accordance with the condition now in paragraph 4.2.2(a) and such designation does not satisfy that condition at the date of initial application.

(c) may revoke its previous designation of a financial liability as measured at fair value through profit or loss if such designation was made at initial recognition in accordance with the condition now in paragraph 4.2.2(a) and such designation satisfies that condition at the date of initial application.

Such a designation and revocation shall be made on the basis of the facts and circumstances that exist at the date of initial application. That classification shall be applied retrospectively.

7.2.11 If it is impracticable (as defined in Ind AS 8) for an entity to apply retrospectively the effective interest method, the entity shall treat:

(a) the fair value of the financial asset or the financial liability at the end of each comparative period presented as the gross carrying amount of that financial asset or the amortised cost of that financial liability if the entity restates prior periods; and

(b) the fair value of the financial asset or the financial liability at the date of initial application as the new gross carrying amount of that financial asset or the new amortised cost of that financial liability at the date of initial application of this Standard.

7.2.12-7.2.13 [Refer Appendix 1]

7.2.14 At the date of initial application, an entity shall determine whether the treatment in paragraph 5.7.7 would create or enlarge an accounting mismatch in profit or loss on the basis of the facts and circumstances that exist at the date of initial application. This Standard shall be applied retrospectively on the basis of that determination.

7.2.15-7.2.28 [Refer Appendix 1]

Transition for *Prepayment Features with Negative Compensation*

7.2.29 An entity shall apply *Prepayment Features with Negative Compensation* (Amendments to Ind AS 109) retrospectively in accordance with Ind AS 8, except as specified in paragraphs 7.2.30–7.2.34.

7.2.30 An entity that first applies these amendments at the same time it first applies this Standard shall apply relevant provisions of Ind AS 101 instead of paragraphs 7.2.31–7.2.34.

7.2.31 An entity that first applies these amendments after it first applies this Standard shall apply paragraphs 7.2.32–7.2.34. The entity shall also apply the other transition requirements in this Standard necessary for applying these amendments. For that purpose, references to the date of initial application shall be read as referring to the beginning of the reporting period in which an entity first applies these amendments (date of initial application of these amendments).

7.2.32 With regard to designating a financial asset or financial liability as measured at fair value through profit or loss, an entity:

(a) shall revoke its previous designation of a financial asset as measured at fair value through profit or loss if that designation was previously made in accordance with the condition in paragraph 4.1.5 but that condition is no longer satisfied as a result of the application of these amendments;

(b) may designate a financial asset as measured at fair value through profit or loss if that designation would not have previously satisfied the condition in paragraph 4.1.5 but that condition is now satisfied as a result of the application of these amendments;

(c) shall revoke its previous designation of a financial liability as measured at fair value through profit or loss if that designation was previously made in accordance with the condition in paragraph 4.2.2(a) but that condition is no longer satisfied as a result of the application of these amendments; and

(d) may designate a financial liability as measured at fair value through profit or loss if that designation would not have previously satisfied the condition in paragraph 4.2.2(a) but that condition is now satisfied as a result of the application of these amendments.

Such a designation and revocation shall be made on the basis of the facts and circumstances that exist at the date of initial application of these amendments. That classification shall be applied retrospectively.

7.2.33 An entity is not required to restate prior periods to reflect the application of these amendments. The entity may restate prior periods if, and only if, it is possible without the use of hindsight and the restated financial statements reflect all the requirements in this Standard. If an entity does not restate prior periods, the entity shall recognise any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the date of initial application of these amendments in the opening retained earnings (or other component of equity, as appropriate) of the annual reporting period that includes the date of initial application of these amendments.

7.2.34 In the reporting period that includes the date of initial application of these amendments, the entity shall disclose the following information as at that date of initial application for each class of financial assets and financial liabilities that were affected by these amendments:

(a) the previous measurement category and carrying amount determined immediately before applying these amendments;

(b) the new measurement category and carrying amount determined after applying these amendments;

(c) the carrying amount of any financial assets and financial liabilities in the Balance Sheet that were previously designated as measured at fair value through profit or loss but are no longer so designated; and

(d) the reasons for any designation or de-designation of financial assets or financial liabilities as measured at fair value through profit or loss.

In Appendix B, paragraphs B4.1.11(b) and B4.1.12(b) are amended. Paragraph B4.1.12A is added. Paragraph B4.1.10 has not been amended but has been included for ease of reference. New text is underlined and deleted text is struck through.

Classification (Chapter 4)

Classification of financial assets (Section 4.1)

…

Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding

…

Contractual terms that change the timing or amount of contractual cash flows

B4.1.10 If a financial asset contains a contractual term that could change the timing or amount of contractual cash flows (for example, if the asset can be prepaid before maturity or its term can be extended), the entity must determine whether the contractual cash flows that could arise over the life of the instrument due to that contractual term are solely payments of principal and interest on the principal amount outstanding. To make this determination, the entity must assess the contractual cash flows that could arise both before, and after, the change in contractual cash flows. The entity may also need to assess the nature of any contingent event (ie the trigger) that would change the timing or amount of the contractual cash flows. While the nature of the contingent event in itself is not a determinative factor in assessing whether the contractual cash flows are solely payments of principal and interest, it may be an indicator. For example, compare a financial instrument with an interest rate that is reset to a higher rate if the debtor misses a particular number of payments to a financial instrument with an interest rate that is reset to a higher rate if a specified equity index reaches a particular level. It is more likely in the former case that the contractual cash flows over the life of the instrument will be solely payments of principal and interest on the principal amount outstanding because of the relationship between missed payments and an increase in credit risk. (See also paragraph B4.1.18.)

B4.1.11 The following are examples of contractual terms that result in contractual cash flows that are solely payments of principal and interest on the principal amount outstanding:

(a) a variable interest rate that consists of consideration for the time value of money, the credit risk associated with the principal amount outstanding during a particular period of time (the consideration for credit risk may be determined at initial recognition only, and so may be fixed) and other basic lending risks and costs, as well as a profit margin;

(b) a contractual term that permits the issuer (ie the debtor) to prepay a debt instrument or permits the holder (ie the creditor) to put a debt instrument back to the issuer before maturity and the prepayment amount substantially represents unpaid amounts of principal and interest on the principal amount outstanding, which may include reasonable ~~additional~~ compensation for the early termination of the contract; and

(c) a contractual term that permits the issuer or the holder to extend the contractual term of a debt instrument (ie an extension option) and the terms of the extension option result in contractual cash flows during the extension period that are solely payments of principal and interest on the principal amount outstanding, which may include reasonable additional compensation for the extension of the contract.

B4.1.12 Despite paragraph B4.1.10, a financial asset that would otherwise meet the condition in paragraphs 4.1.2(b) and 4.1.2A(b) but does not do so only as a result of a contractual term that permits (or requires) the issuer to prepay a debt instrument or permits (or requires) the holder to put a debt instrument back to the issuer before maturity is eligible to be measured at amortised cost or fair value through other comprehensive income (subject to meeting the condition in paragraph 4.1.2(a) or the condition in paragraph 4.1.2A(a)) if:

(a) the entity acquires or originates the financial asset at a premium or discount to the contractual par amount;

(b) the prepayment amount substantially represents the contractual par amount and accrued (but unpaid) contractual interest, which may include reasonable ~~additional~~ compensation for the early termination of the contract; and

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

B4.1.12A For the purpose of applying paragraphs B4.1.11(b) and B4.1.12(b), irrespective of the event or circumstance that causes the early termination of the contract, a party may pay **or** receive reasonable compensation for that early termination. For example, a party may pay or receive reasonable compensation when it chooses to terminate the contract early (or otherwise causes the early termination to occur).

In Appendix 1, paragraph 4 is added

Appendix 1

4. Following paragraphs related to transition have not been included as these paragraphs relate to transition considering that these are not relevant. However, in order to maintain consistency with paragraph numbers of IFRS 9, the paragraph numbers are retained in Ind AS 109:

(i) Paragraph 7.2.2

(ii) Paragraphs 7.2.6-7.2.7

(iii) Paragraphs 7.2.12-7.2.13

(iv) Paragraphs 7.2.15-7.2.28