report

Paper CL 15 11 18

Board	CIPFA/LASAAC
Venue	NA
Date	November 2018
Author	Sarah Sheen, Technical Manager
Subject	Proposal for an Update to the 2018/19 Code

Purpose

To consider an update the 2018/9 Code following the decisions made at the November 2018 meeting for IFRS 9 *Financial Instruments* amendments.

1 Introduction

1.1 The Board considered the detail of the consultation responses on the Code at its meeting on 6 November 2018. This report provides the further information requested by the Board at its meeting in relation IFRS 9 *Financial Instruments*: Prepayment Features with Negative Compensation (IASB October 2017).

Modification or Exchange of a Financial Liability that does not Result in Derecognition

1.2 CIPFA/LASAAC will be aware that the amendments to the standard bring forward this issue in two new basis of conclusions paragraphs BC4.252 and BC4.253. BC4.253 comments:

'*the Board highlighted 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.*'

1.3 The IASB therefore clarifies in the new basis of conclusions paragraphs that an entity recognises any adjustment to the amortised cost of the financial liability arising from a modification or exchange in profit or loss at the date of the modification or exchange and that the new amortised cost should be measured using the original and not the new effective interest rate.

1.4 CIPFA/LASAAC is aware that the basis of conclusions confirms that standard setting is not required and there are no amendments to the provisions of IFRS 9. This would include the transitional provisions of IFRS 9 which cannot therefore have specifically anticipated this change.

1.5 This treatment is different to the treatment that accounts preparers might have adopted under IAS 39 which allowed for approaches where the amortised cost was calculated using the effective interest rate for such modifications. The Secretariat can confirm that accounting literature on this issue comments that this change may lead to a change in accounting treatment or practices. Additionally, the Code Guidance Notes advocated a different treatment to the new clarifications in the basis of conclusions.

1.6 As noted above the consultation papers were issued not specifically anticipating that this transaction would substantially occur for local authorities (although see further discussion below). As noted in the report and confirmed to CIPFA/LASAAC at their meeting, as there are no changes to IFRS 9 there are no specific provisions in the standard against which to change the accounting practices in the Code. Also as indicated at the CIPFA/LASAAC meeting the transitional provisions in IFRS 9 which include reliefs are specific and deal only with the changes in relation to classification and measurement, the expected credit loss model and hedge accounting. Therefore without any commentary in the Code full retrospective restatement (including preceding year information) would be required. The Secretariat would note that this also appears to be confirmed by accounting literature in its researches on this issue.

1.7 The Secretariat would argue strongly therefore that:

- as local authorities would only be recently aware of this issue which was confirmed after IFRS 9 was issued
- for consistency with the other transitional provisions of the standard
- arguably to ensure that the key messages on transition are clear
- as this would ease the reporting burden because local authorities will already be considering the substantial transitional arrangements for both IFRSs 9 and 15 *Revenue from Contracts with Customers*

the Code should stipulate that if local authorities have to change their accounting practices on transition any adjustments should be made on a modified retrospective basis consistent with the approach to the other transitional provisions in IFRS 9. The Secretariat would note that as recognised by CIPFA/LASAAC at its meeting this would be an adaptation to the transitional provisions of IFRS 9 and for IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

1.8 CIPFA/LASAAC requested some further information on the size and frequency of the transaction for local authorities. This has been provided in Appendix 1 to this report. Only four names have been provided out of the six authorities' providing information. CIPFA/LASAAC will note that there are four English authorities and two Welsh authorities. The Secretariat can identify the individual authorities on request. The Secretariat would note that the Treasury Management advisor is of the view that other authorities may be in this situation. The Secretariat would note that a number of the principal amounts appear to be material.

1.9 The Secretariat would recommend that although there are not at this juncture substantial numbers of authorities with such transactions it would assist accounts preparers if CIPFA/LASAAC is explicit about this transaction in the Code's provisions and assist with the raising awareness about this transaction. The Secretariat has therefore provided a short Update to the 2018/19 Code in accordance with CIPFA/LASAAC's request.

Recommendation

CIPFA/LASAAC's is invited to consider the comments above and agree to issue an Update to the 2018/19 Code for modification or exchanges of financial liabilities that do not result in derecognition.

<u>Table of Known Historical Modifications from a Sample of Authorities</u>

	Replacement Loans				Premiums / Discounts on Modification		Original Loans	
Authority Code	**No.**	**Sources**	**Year(s) Taken Out**	**Total Amount**	**Premiums**	**Discounts**	**No.**	**Amount**
A	1	PWLB	2006	£18,600,000	£3,462,893		14	£18,600,000
B	1	PWLB	2006	£32,228,828	£1,054,927		10	£32,228,828
C	12	PWLB	2003-2006	£27,469,260	£362,117	-£530,476	12	£27,469,260
D	3	Commercial Banks, all stepped LOBOs	2002-2004	£13,600,000	£1,934,679	-£27,297	15	£12,632,189.49
E	9	PWLB	1997-2001	£23,489,302	£3,131,407		14	£23,476,707
F	13	Primarily PWLB, one commercial bank stepped LOBO £5m	1997-2006	£121,000,000	£4,897,180	-£199,889	32	£121,000,000
Totals	**39**		**1997-2006**	**£236,387,390**	**£14,843,204**	**-£757,662**	**97**	**£235,406,984**

This table is a summary of information provided a treasury management advisor relating to clients with known historical modification arrangements.

For further information the rounded averages (not weighted) for replacement loans are:

- Value: £6.1m
- Term when taken out: 44 years
- Term remaining as at 31/3/18: 28 years