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EFRAG's Draft Letter to the European Commission Regarding Endorsement of Prepayment features with negative compensation (Amendments to IFRS 9)

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European Commission
1049 Brussels

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Dear Mr Guersent,

Endorsement of *Prepayment Features with Negative Compensation (Amendments to IFRS 9)*

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards, EFRAG is pleased to provide its opinion on *Prepayment Features with Negative Compensation (Amendments to IFRS 9)* ('the Amendments'), which were issued by the IASB on 12 October 2017. An Exposure Draft of the Amendments was issued on 21 April 2017. EFRAG provided its comment letter on that Exposure Draft on 31 May 2017.

The objective of the Amendments is to address the classification of particular prepayable financial assets applying IFRS 9 *Financial Instruments*. More precisely, it addresses the situation where the lender could be forced to accept a prepayment amount that is substantially less than unpaid amounts of principal and interest. Such a prepayment amount would include an amount that reflects a payment to the borrower by the lender (instead of compensation from the borrower to the lender) even though the borrower chose to terminate the contract early. This is referred to as 'negative compensation'.

The Amendments become effective for annual periods beginning on or after 1 January 2019, with earlier application permitted. A description is included in Appendix 1 to this letter.

In order to provide our advice as you have requested, we have first assessed whether the Amendments would meet the technical criteria for endorsement, in other words whether the Amendments would provide relevant, reliable, comparable and understandable information required to support economic decisions and the assessment of stewardship, lead to prudent accounting and are not contrary to the true and fair view principle. We have then assessed whether the Amendments would be conducive to the European public good. We provide our conclusions below.

Do the Amendments meet the IAS Regulation technical endorsement criteria?

In addressing the measurement uncertainty relating to financial instruments with negative prepayment features, EFRAG has concluded that the Amendments meet the qualitative characteristics of relevance, reliability, comparability and understandability required to support economic decisions and the assessment of stewardship, and raise no issues regarding prudent accounting.

EFRAG has also assessed that the Amendments do not create any distortion in their interaction with other IFRS Standards and that all necessary disclosures are required. Therefore, EFRAG has concluded that the Amendments are not contrary to the true and fair view principle. EFRAG's reasoning is explained in Appendix 2 to this letter.

Are the Amendments conducive to the European public good?

EFRAG has assessed that the Amendments would improve financial reporting and would reach an acceptable cost-benefit trade-off. EFRAG has not identified that the Amendments could have any adverse effect on the European economy, including financial stability and economic growth. EFRAG further notes that the Amendments address concerns raised by European constituents in applying IFRS 9 requirements to financial instruments with negative prepayment features. Based on the above considerations, EFRAG assesses that endorsing the Amendments is conducive to the European public good. EFRAG's reasoning is explained in Appendix 3 to this letter.

In EFRAG's assessment of whether the Amendments would be conducive to the European public good, EFRAG has assessed whether the Amendments would improve financial reporting, would reach an acceptable cost-benefit trade-off, and whether the Amendments could affect economic growth.

Our advice to the European Commission

As explained above, we have concluded that the Amendments meet the qualitative characteristics of relevance, reliability, comparability and understandability required to support economic decisions and the assessment of stewardship, raise no issues regarding prudent accounting, and that they are not contrary to the true and fair view principle. We have also concluded that the Amendments are conducive to the European public good. Therefore, we recommend the Amendments for endorsement.

We bring to the attention of the European Commission that the effective date of the Amendments is after the effective date of IFRS 9. We have been advised that the ability to apply the Amendments early and at the same time as applying IFRS 9 would reduce costs for both preparers and users. Consequently, EFRAG has accelerated the development of its endorsement advice in order to complete its part of the endorsement process as speedily as possible.

On behalf of EFRAG, I would be happy to discuss our advice with you, other officials of the European Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely,

Jean-Paul Gauzès
President of the EFRAG Board

Appendix 1: Understanding the changes brought about by the Amendments

Background of the Amendments

1 After IFRS 9 *Financial Instruments* was issued, the IFRS Interpretations Committee (the Interpretations Committee) received a submission asking how to classify particular prepayable financial assets applying IFRS 9. Specifically, the submission asked whether a debt instrument could have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding if its contractual terms permit the borrower to prepay the instrument at an amount that could be more or less than unpaid amounts of principal and interest, such as at the instrument's current fair value or at an amount that reflects the remaining contractual cash flows discounted at the current market interest rate.

2 As a result of such a contractual prepayment feature, the lender could be forced to accept a prepayment amount that is substantially less than unpaid amounts of principal and interest. Such a prepayment amount would, in effect, include an amount that reflects a payment to the borrower ~~by~~from the lender (instead of compensation from the borrower to the lender~~)~~), even though the borrower chose to ~~terminate~~prepay the ~~contract early~~debt instrument. This is referred to as negative compensation.

The issue and how it has been addressed

3 The Interpretations Committee ~~concluded~~indicated that, applying IFRS 9, those contractual cash flows are not solely payments of principal and interest, and therefore the financial assets would be measured at fair value through profit or loss.

4 However, Interpretations Committee members suggested that the IASB consider whether using amortised cost measurement could provide useful information about particular financial assets with such prepayment features, and if so, whether the requirements in IFRS 9 should be changed in this respect.

5 In the light of the Interpretations Committee's recommendation and similar concerns raised by banks and their representative bodies in response to the Interpretations Committee's discussion, the IASB ~~decided to propose a change~~proposed amendments to IFRS 9 for ~~those~~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 that may result in negative compensation. Applying the ~~proposals~~Amendments, such financial assets would be eligible 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.

What has changed?

6 The Amendments propose a change 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 negative prepayment feature.

7 Specifically, for a financial ~~instruments which contain~~asset that contains a prepayment amount that may result in negative compensation, the Amendments ~~propose that, in applying paragraphs B4.1.11(b) and B4.1.12(b) of IFRS 9, such a financial asset would be eligible~~require the financial asset to be measured at amortised cost or at fair value through other comprehensive income, subject to the assessment of the business model in which it is held.

When do the Amendments become effective?

8 An entity shall apply the Amendments for annual periods beginning on or after 1 January 2019. Earlier application is permitted. If an entity applies the Amendments for an earlier period, it shall disclose that fact.

9 The Amendments include relevant disclosures. They shall be applied retrospectively, except as specified below.

10 When an entity first applies the Amendments at the same time it first applies IFRS 9, ~~then~~ the entity applies the transition requirements of IFRS 9. In contrast, when an entity first applies the Amendments after it first applies IFRS 9, specific transition requirements are ~~applicable that are necessary for applying~~provided in the Amendments.

~~11 If an entity applies the Amendments for the first time after it applies IFRS 9 then the entity is permitted to newly designate and is required to revoke its previous designation of, a financial asset or a financial liability at the date of initial application of the Amendments only to the extent that a new accounting mismatch is created, or a previous accounting mismatch no longer exist, as a result of the Amendments.~~

~~12~~11 An entity is not required to restate prior periods to reflect the effect of the Amendments, and can choose to do so only if it is possible without the use of hindsight and if the restated financial statements reflect all the requirements of IFRS 9. Specific disclosures are required if an entity does not restate prior periods.

~~Finally, disclosures about transition are included. i.e. in the reporting period that includes the date of initial application of~~

Appendix 2: EFRAG's technical assessment on the Amendments against the endorsement criteria

Notes to Constituents:

This appendix sets out the basis for the conclusions reached, and for the recommendation made, by EFRAG on the Amendments. In it, EFRAG assesses how the Amendments satisfy the technical criteria set out in the Regulation (EC) No 1606 2002 for the adoption of international accounting standards. It provides a detailed evaluation for the criteria of relevance, reliability, comparability and understandability, so that financial information is appropriate for economic decisions and the assessment of stewardship. It evaluates separately whether the Amendments lead to prudent accounting and finally considers whether the Amendments would not be contrary to the true and fair view principle.

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG's capacity of contributing to the IASB's due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity of advising the European Commission on endorsement of the definitive IFRS Standards in the European Union and European Economic Area.

In the latter capacity, EFRAG's role is to make a recommendation about endorsement based on its assessment of the final IFRS Standard or Interpretation against the technical criteria for European endorsement, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRS Standards or Interpretations. Another reason for a difference is that EFRAG's thinking may evolve.

Does the accounting that results from the application of the Amendments meet the technical criteria for endorsement in the European Union?

1 EFRAG has considered whether the Amendment meets the technical requirements of the European Parliament and of the Council on the application of international accounting standards, as set out in Regulation (EC) No 1606/2002 (The IAS Regulation), in other words that the Amendments:

(a) are not contrary to the principle set out in Article 4 (3) of Council Directive 2013/34/EU (the Accounting Directive); and

(b) meet the criteria of understandability, relevance, reliability, and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

2 Article 4(3) of the Accounting Directive provides that:

The annual financial statements shall give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss. Where the application of this Directive would not be sufficient to give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss, such additional information as is necessary to comply with that requirement shall be given in the notes to the financial statements.

3 The IAS Regulation further clarifies that *'to adopt an international accounting standard for application in the Community, it is necessary firstly that it meets the basic requirement of the aforementioned Council Directives, that is to say that its application results in a true and fair view of the financial position and performance of*

an enterprise - this principle being considered in the light of the said Council Directives without implying a strict conformity with each and every provision of this Directive' (Recital 9 of the IAS Regulation).

4 EFRAG's assessment as to whether the Amendments would not be contrary to the true and fair view principle has been performed against the European legal background summarised above.

5 In its assessment, EFRAG has considered the Amendments from the perspectives of both usefulness for decision-making and assessing the stewardship of management. EFRAG has concluded that the information resulting from the application of the Amendments is appropriate both for making decisions and assessing the stewardship of management.

Relevance

6 Information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations. Information is also relevant when it assists in evaluating the stewardship of management.

7 EFRAG considered whether the Amendments would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or whether it would result in the omission of relevant information.

8 In assessing relevance EFRAG has looked at the following issues:

(a) Prepayment features with negative and positive compensation;

(b) Amortised cost measurement~~ or fair value through other comprehensive income ('FVOCI'); ~~; and

~~(a) ~~Effective date of 1 January 2019 with early application~~; and~~

(c) ~~Transition~~.

Prepayment features with negative and positive compensation

9 Currently, IFRS 9 ~~*Financial Instruments* ~~does not provide explicit guidance as to whether a prepayable financial asset may be eligible to be measured at amortised cost or fair value through other comprehensive income (FVOCI) if the party exercising its option to terminate the contract receives instead of pays compensation~~, also~~. This is commonly referred to as 'negative compensation'.

10 EFRAG notes that financial instruments that incorporate prepayment features with negative compensation do not ~~introduce~~include contractual cash flows payments of principal and interest that are different from the cash flows that may arise from financial instruments with positive compensation. ~~It merely changes~~The contracts supporting such financial instruments merely change the circumstances in which the 'compensation' amounts could arise, and the potential sign of the compensation~~, by increasing~~ component of the prepayment, and may increase the frequency of occurrence of contractual compensation~~ amounts~~. Consequently, EFRAG considers that measurement at amortised cost or at FVOCI ~~can provide~~provides relevant information for financial instruments with prepayment features with negative compensation.

Amortised cost measurement ~~or FVOCI~~

11 The Amendments state that~~, in applying paragraphs B4.1.11(b) and B4.1.12(b) of IFRS 9,~~ a financial asset that contains a prepayment ~~amount~~feature that may result in negative compensation, would be eligible to be measured at amortised cost or at FVOCI, subject to the assessment of the business model in which it is held.

~~13 EFRAG acknowledges that the business model condition for:~~

~~(a) amortised cost reflects the objective of holding financial assets to collect their contractual cash flows; and~~

~~(b) FVOCI reflects the objective of both holding the financial assets and selling them.~~

12 EFRAG acknowledges that situations can occur where the lender of the debt instrument could be forced to accept a prepayment amount that is less than the amount of unpaid principal and interest. However, EFRAG notes that IFRS 9 accommodates contractual terms that permit either the borrower or the lender to choose to terminate the contract early and compensate the other party for having to accept that choice. Accordingly, IFRS 9 already accommodates a prepayment amount that is more or less than unpaid amounts of principal and interest, depending on which party chooses to terminate the contract early.

13 EFRAG also considers that in applying the effective interest method to measure such financial assets at amortised cost at initial recognition, the entity considers the contractual cash flows arising from such a prepayment feature when it estimates the future cash flows and determines the effective interest rate at initial recognition. Subsequently, consistent with the treatment of all financial instruments measured at amortised cost, the entity adjusts the gross carrying amount of the financial asset if it revises its estimates of contractual cash flows, including any revisions related to the exercise of the prepayment feature.

14 EFRAG notes that, in some situations, both the borrower and the lender have the option to terminate the loan before maturity and, if the loan is terminated early, the prepayment amount includes compensation that reflects the change in the relevant benchmark interest rate. For example, if the loan is terminated early (by either party) and the relevant benchmark interest rate has fallen since the loan was initially recognised, then the lender will effectively receive an amount representing the present value of lost interest revenue over the loan's remaining term. Conversely, if the contract is terminated early (by either party) and the relevant benchmark interest rate has risen, then the borrower will effectively receive an amount that represents the effect of that change in that interest rate over the loan's remaining term.

~~12~~15 Consistent with paragraph 10 above, EFRAG acknowledges that the contractual terms of financial instruments that incorporate prepayment features with negative compensation do not introduce different contractual cash flow amounts from the contractual cash flow amounts accommodated by ~~paragraph B4.1.11(b) of~~ IFRS 9 ~~(as issued in 2014).~~. That is, the financial instrument's prepayment amount is calculated in the same way as a positive prepayment amount ~~accommodated by paragraph B4.1.11(b) of IFRS 9 (as issued in 2014). Specifically, the prepayment amount~~and reflects unpaid amounts of principal and interest plus or minus an amount that reflects the effect of the change in the relevant benchmark interest rate.

~~14 EFRAG therefore assesses that, as long as the business model condition in paragraph has been met and the fair value option has not been elected, amortised cost provides relevant information about the expected credit loss and interest revenue calculated using the effective interest method. EFRAG assesses that the existence of a prepayment feature with negative compensation does not prevent a financial instrument from being a basic lending instrument, even when being held in a business model where performance is affected by both contractual cash flows and the realisation of fair value through sales. Hence, EFRAG assesses that FVOCI measurement can also provide relevant information for instruments with a prepayment feature with negative compensation.~~

Effective date of 1 January 2019 with early application

~~13~~16 The Amendments are applicable for annual periods beginning on or after 1 January 2019, with earlier application permitted.

~~14~~17 EFRAG assesses that early application will allow entities to apply the Amendments at the same time as IFRS 9 is applied. In such cases, where IFRS 9 and the Amendments are applied at the same time, it will lead to ~~more~~ relevant information as it allows entities to measure and present their financial instruments in line with their business model.

~~15~~18 Where an entity does not early adopt the Amendments, EFRAG notes that these instruments might fail the solely payments of principal and interest ('SPPI') test. As a result, financial instruments that will be measured using amortised cost or FVOCI will need to be measured at fair value through profit or loss in accordance with IFRS 9. When the Amendments become applicable, entities would then have to revise their measurement of such instruments to amortised cost or FVOCI. EFRAG assess that the interim measurement of such instruments at fair value through profit or loss until the ~~Amendment becomes~~Amendments become applicable might restrict the relevance of information as fair value measurement might not be in line with the business model under which such instruments are being held.

~~16~~19 However, EFRAG acknowledges that this is mitigated by the fact that:

(a) there is only one year between the effective date of IFRS 9 and the effective date of the Amendments; and

(b) when applying the Amendments for the first time, entities are required to disclose information ~~about the previous carrying amount and measurement category of such instruments~~to enable users to understand the effect of the change.

~~17~~20 Therefore, EFRAG assesses that the effective date of 1 January 2019, with early application permitted results in information that is relevant to users of the financial statements.

~~*Transition*~~

~~*General*~~

~~15 At transition, entities are required to apply the Amendments retrospectively unless impracticable. The same transition provisions in IFRS 9 would apply if the Amendments are applied when it initially applies IFRS 9, therefore no transition provisions are needed for the Amendments.~~

~~16 EFRAG considers that a retrospective approach provides the most relevant information for users because financial instruments that contain prepayment features with negative compensation will be accounted for as if they had always applied the Amendments.~~

~~*Transition requirements for entities applying the Amendments for the first time after they apply IFRS 9*~~

~~17 Specific transition provisions are provided for entities that will apply the Amendments after the initial application of IFRS 9, as the transition provisions in IFRS 9 would not be available in such cases. These specific transition provisions allow entities to newly designate, and require them to revoke their previous designation of, a financial asset at the date of initial application of the Amendments only to the extent that a new accounting mismatch is created, or a previous accounting mismatch no longer exists, as a result of applying the Amendments.~~

~~18 EFRAG considers that such transition requirements are necessary as the Amendments will ensure that entities classify and measure basic lending instruments containing prepayment features with negative compensation in accordance with the business model under which they are managed.~~

Conclusion

~~18~~21 Overall, based on the above analysis, EFRAG concludes that the Amendments will result in relevant information.

Reliability

~~19~~22 EFRAG also considered the reliability of the information that will be provided by applying the Amendments. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent, or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.

~~20~~23 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness.

~~21~~24 In assessing reliability EFRAG has looked at the issue of transition.

Transition

~~22~~25 Entities that apply the Amendments after applying IFRS 9, are not required to restate prior periods to reflect the application of the Amendments. Entities 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.~~IFRS 9.

~~23~~26 EFRAG notes that by not restating comparative information, the reliability of information could be reduced for an instrument that would have always been carried at an amortised cost ~~taking into account the Amendments. However, EFRAG acknowledges that, in such cases, entities are required to calculate the carrying amount at the beginning of the annual period that includes the date of initial application of the Amendments and recognise the difference between the new and previous carrying amount in either retained earnings or other component of equity, as appropriate.~~if the Amendments had been applied early.

~~24~~27 EFRAG assesses that, as the difference in the carrying amount will be quantified and additional disclosures are required as part of the Amendments, users will have sufficient information available to evaluate the impact of the Amendments therefore the reliability of information provided is not reduced.

~~**Question to EFRAG TEG**~~

~~19 Do EFRAG TEG members agree the above issue affects primarily the reliability of the information or rather the comparability aspect of it? Please explain.~~

Conclusion

~~25~~28 Overall, EFRAG concludes that the Amendments will result in reliable information.

Comparability

~~26~~29 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.

~~27~~30 EFRAG has considered whether the Amendments result in transactions that are:

(a) economically similar being accounted for differently; or

(b) transactions that are economically different being accounted for as if they are similar.

~~28~~31 In assessing comparability EFRAG has looked at the following issues:

(a) avoiding future diversity in practice;

(b) prepayment features with negative and positive compensation; and

~~(a)~~ transition requirements for entities applying the Amendments for the first time after they apply IFRS 9~~; and~~

(c) ~~Effective date of 1 January 2019 with early application~~.

Avoiding future diversity in practice

~~29~~32 EFRAG notes that ~~the Amendments ensure that financial instruments with negative prepayment features are all accounted for in the same way. Without the clarification brought by~~without the Amendments, the risk existed that diversity in practice could arise when implementing IFRS 9~~.~~ as different views existed on how financial instruments with negative prepayment features should be classified. EFRAG assesses that ~~this contributes~~the Amendments clarify the appropriate treatment and, thus, contribute to comparability of the resulting ~~accounting~~information.

Prepayment features with negative and positive compensation

~~30~~33 EFRAG notes that the Amendments align the eligibility criterion for prepayment features with negative compensation to those prepayment features with positive compensation. EFRAG assesses this as resulting in comparable information when measuring financial instruments with prepayment features~~.~~, as the prepayment contractual terms do not introduce different cash flow amounts before a prepayment event. EFRAG notes that, as long as the ~~additional~~ compensation for early termination of the contract is reasonable, the sign of that compensation does not overrule the fact that the underlying financial instruments are comparable, as they do not introduce variability that is inconsistent with a basic lending ~~agreement~~arrangement.

Transition requirements for entities applying the Amendments for the first time after they apply IFRS 9

~~20~~ Entities are provided with a choice as to whether to restate prior periods to reflect the application of the Amendments. However, EFRAG notes that restatement is not permitted when it cannot be applied without the use of hindsight. EFRAG ~~also~~ considers that disclosures around the measurement and recognition before and after applying the Amendments, irrespective of which option an entity chooses, mitigates ~~the~~any potential lack of comparability.

~~*Effective date of 1 January 2019 with early application*~~

~~21 The Amendments are to be applied as from the annual periods beginning on or after 1 January 2019 with earlier application permitted. This while IFRS 9 is being applied as from 1 January 2018.~~

~~22 It is argued by some that such an effective date may result in information to users of financial statements that is not comparable. The reason for this is that when endorsement is not completed by 1 January 2018 (or by the first filing in which IFRS 9 is applied), European entities would still need to apply the revised version of IFRS 9 soon after transitioning to the existing version.~~

~~23 EFRAG acknowledges this comment but notes that entities are required to disclose the known or reasonable estimable information relevant in assessing the possible impact of application of a new IFRS Standard will have on the entity's financial statements in the period of initial application.~~

~~31~~34 ~~EFRAG assesses that disclosing the impact of the Amendments on the entity's financial statements in the period of initial application can remove some of the concerns in making the changes comparable to users of financial statements. The reduction in comparability of information that remains is somewhat balanced by the fact that European entities that are SEC-filers would not have to publish two sets of financial statements.~~

Conclusion

~~32~~35 Overall, EFRAG concludes that the Amendments lead to comparable information.

Understandability

~~33~~36 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting, and the willingness to study the information with reasonable diligence.

~~34~~37 Although there are a number of aspects related to the notion of 'understandability', EFRAG believes that ~~most of the~~all relevant aspects are covered by the discussion above about relevance, reliability and comparability.

~~24 As a result, EFRAG believes that the main additional issue it needs to consider, in assessing whether the information resulting from the application of the Amendments is understandable, is whether that information will be unduly complex.~~

~~35~~38 EFRAG has not identified any issues that affect the understandability of the Amendments.

Prudence

~~36~~39 For the purpose of this endorsement advice, prudence is defined as caution in conditions of uncertainty. In some circumstances, prudence requires asymmetry in recognition such that assets or income are not overstated and liabilities or expenses are not understated.

~~37~~40 Prudence is different from and unrelated to prudential reporting. The former is a qualitative characteristic used in accounting standard setting and is applicable to the financial statements of all companies. The latter refers to the reporting by individual financial institutions to regulators in order to meet the regulator's objectives (such as capital adequacy and liquidity).

~~38~~41 EFRAG did not identify any aspects of the Amendments that would affect prudence.

True and Fair View Principle

~~39~~42 A Standard will not impede information from meeting the true and fair view principle when, on a stand-alone basis and in conjunction with other IFRS Standards, it:

(a) does not lead to unavoidable distortions or significant omissions in the representation of that entity's assets, liabilities, financial position and profit or loss; and

(b) includes all disclosures that are necessary to provide a complete and reliable depiction of an entity's assets, liabilities, financial position and profit or loss.

43 ~~Assessment of true and fair view to be developed.~~EFRAG has assessed that the Amendments do not create any negative interactions with other IFRS Standards and are designed to complement IFRS 9. Accordingly, EFRAG has assessed that the Amendments do not lead to unavoidable distortions or significant omissions and therefore do not impede financial statements from providing a true and fair view.

44 EFRAG has concluded that the appropriate disclosures that are necessary to provide a complete and reliable depiction of an entity's assets, liabilities, financial position and profit or loss are required.

45 As a result, EFRAG concludes that the application of the Amendments would not lead to information that would be contrary to the true and fair view principle.

Conclusion

46 Accordingly, for the reasons set out above, EFRAG's assessment is that the Amendments meet the technical requirements for EU endorsement as set out in the IAS Regulation.

Appendix 3: Assessing whether the Amendments are conducive to the European public good

Introduction

1 EFRAG considered whether it would be conducive to the European public good to endorse the Amendments. In addition to its assessment included in Appendix 2, EFRAG has considered a number of issues in order to identify any potential negative effects for the European economy on the application of the Amendments. In doing this, EFRAG considered:

(a) whether the Amendments improve financial reporting. This requires a comparison of the Amendments with the existing requirements and how they fit into IFRS Standards as a whole;

(b) the costs and benefits associated with the Amendments; and

(c) whether the Amendments could have an adverse effect to the European economy, including financial stability and economic growth.

2 These assessments allow EFRAG to draw a conclusion as to whether the Amendments are likely to be conducive to the European public good. If the assessment concludes there is a net benefit, the Amendments will be conducive to the objectives of the IAS Regulation.

EFRAG's evaluation of whether the Amendments are likely to improve the quality of financial reporting

3 The Amendments propose a change 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 that may result in negative compensation. Specifically, for financial instruments that contain a prepayment amount that may result in negative compensation, the Amendments propose that such a financial asset would be eligible to be measured at amortised cost or at fair value through other comprehensive income, subject to the assessment of the business model in which it is held.

4 EFRAG understands that the proposed Amendments address those prepayment features that would meet the requirements for measurement at amortised cost under IFRS 9, except for the fact that they could result in compensation for the early termination of the contract that is negative. EFRAG understands that this condition would require the negative compensation to be 'reasonable', consistent with the requirement for positive compensation.

5 EFRAG also observes that the Amendments address concerns raised by European constituents in applying IFRS 9 to financial instruments with negative prepayment features, as they reduce the uncertainty in interpreting the IFRS 9 requirements for accounting for financial instruments with negative compensation. As noted in Appendix 2, without the Amendments, the risk existed that diversity in practice could arise when implementing IFRS 9.

6 EFRAG has therefore concluded that the Amendments are likely to improve the quality of financial reporting.

EFRAG's initial analysis of the costs and benefits of the Amendments

7 EFRAG first considered the extent of the work. For some IFRS Standards or Interpretations, it might be necessary to carry out some extensive work, in order to understand fully the cost and benefit implications of the IFRS Standard or Interpretation being assessed. However, in the case of the Amendments, EFRAG's

view is that the cost and benefit implications can be assessed by carrying out a more modest amount of work.

Cost for preparers

8 EFRAG has carried out an assessment of the cost implications for preparers resulting from the Amendments.

9 Entities that will be affected by the Amendments will have to measure financial assets with negative compensation at amortised cost or at fair value through other comprehensive income, subject to the assessment of the business model in which they are held.

10 EFRAG does not expect preparers that apply the Amendments at the same time they apply IFRS 9 to incur significant one-off costs resulting from the Amendments and will benefit from the transition provisions already available in IFRS 9. EFRAG assessed that the main cost for these entities will be the one-off cost to provide the transition disclosures.

11 On the other hand, preparers that will apply the Amendments later than they apply IFRS 9 would have to classify and measure financial assets in accordance with the existing version of IFRS 9 and then reassess the classification and measurement of financial assets to which the Amendments are applied later. EFRAG assesses that due to such a reassessment within a short time-frame, preparers will incur some costs, including communicating the change to the users of the financial statements.

12 However, EFRAG assesses that the one-off costs of implementation for preparers are not expected to be significant, as the information necessary is already available to the entity.

13 Moreover, EFRAG does not expect preparers to incur additional ongoing costs due to the application of the Amendments.

14 Overall, EFRAG's assessment is that the Amendments are likely to result in insignificant costs for preparers related to implementation and ongoing application of the Amendments.

Costs for users

15 EFRAG has carried out an assessment of the cost implications for users resulting from the Amendments.

16 The main cost for users will be the one-off cost to understand the change brought by the Amendments, especially in cases of entities that will apply the Amendments later than they apply IFRS 9.

17 Moreover, EFRAG does not expect users to incur additional ongoing costs due to the application of the Amendments.

18 Overall, EFRAG's assessment is that the Amendments are likely to result in insignificant costs for users which are limited to understanding the new requirements.

Benefits for preparers and users

19 EFRAG has carried out an assessment of the benefits for users and preparers resulting from the Amendments.

20 EFRAG observed that the amendments are designed to address the concerns of some interested parties about how IFRS 9 classifies particular prepayable financial assets. EFRAG considered that the Amendments improve guidance in IFRS 9 that could be interpreted in different ways. Therefore, in EFRAG's view, users will benefit from a more consistent application of the requirements in IFRS 9 as this will improve the resulting financial information on financial instruments with prepayment features and therefore will enhance their analysis. Further, preparers are expected to benefit

from reducing the effort required to determine how the guidance should be interpreted.

21 Overall, EFRAG's assessment is that users and preparers are likely to benefit from the Amendments.

Conclusion on the costs and benefits of the Amendments

22 EFRAG's overall assessment is that the overall benefits of the users resulting from improved financial information being available on a more relevant, understandable and comparable basis, are likely to outweigh costs of preparers associated with implementation of the Amendments, which are considered as insignificant.

Conclusion

23 EFRAG believes that the Amendments will generally bring improved financial reporting when compared to current guidance in IFRS 9. As such, their endorsement is conducive to the European public good in that improved financial reporting improves transparency and assists in the assessment of management stewardship.

24 EFRAG has not identified the Amendments could have any adverse effect to the European economy, including financial stability and economic growth.

25 Furthermore, EFRAG has considered whether there are any other factors that would mean endorsement is not conducive to the public good and has not identified any such factors.

26 Having considered all relevant aspects, including the trade-off between the costs and benefits of implementing the Amendments, EFRAG assesses that endorsing the Amendments is conducive to the European public good.