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Chairman

Paris, 6 February 2019

Mrs Lloyd
IFRS Interpretations Committee Chair
7 Westferry Circus, Canary Wharf
London, UK, E14 4HD

November 2018 - IFRS-IC tentative agenda decisions

Dear Mrs Lloyd, Dear Sue,

I am writing on behalf of the Autorité des Normes Comptables (ANC) to express our views on the IFRS-IC tentative decisions published in November 2018 IFRIC Update regarding IFRS 9 – *Physical settlement of contracts to buy or sell a non-financial item*, IAS 38 – *Customer's right to access the supplier's software hosted on the cloud* as well as IFRS 9 – *Curing of a credit-impaired financial asset*. This letter sets out some of the most critical comments raised by interested stakeholders involved in ANC's due process.

Physical settlement of contracts to buy or sell a non-financial item (IFRS 9)

ANC does not disagree with the tentative decision. ANC notes however that in the energy industry, when neither the own-use exception nor the hedge accounting is applied, entities often manage contracts measured at fair value through P&L (IFRS 9.2.5) to achieve an economic hedge. Upon physical settlement, there is a common practice to present the accumulated fair value gain or loss on the derivative on one line in the P&L that differs from the one where the sale/purchase is recorded (at contract's value instead of the fair value retained in the fact pattern).

ANC understands that this current accounting practice reflects the way performance is analysed, both by management and by external users of the financial statements. The Committee's suggested accounting treatment might have significant impact on this current practice and be disruptive. ANC is concerned that this could result in increasing the use of non-GAAP information to meet user's expectations.

The issue is partially linked to the dual practice in the industry to settle net and physically. ANC suggests that IASB considers, as part of its standard-setting activity, the accounting treatment of these contracts that are neither held for trading nor eligible to the own-use exception and that are eventually physically settled.

Customer's right to access the supplier's software hosted on the cloud (IAS 38)

ANC concurs with the conclusion of the Committee that IFRS 16 does not apply to the customer's right to access the supplier's software hosted on the cloud since such contract does not convey a right to control the use of the underlying asset but only a right to receive access.

As implicitly suggested by the tentative decision, we support applying either of both solutions (service or asset) depending on facts and circumstances.

We are concerned that an agenda decision beyond the sole conclusion on the scope exemption of IFRS 16 may have unintended consequences and therefore suggest limiting the decision to that statement.

Furthermore, we note that IAS 38 has been issued to deal with intangible assets such as development costs, brands and licenses but may not properly apply to emerging transactions in a digital economy including but not limited to SAAS, crypto-assets and blockchain…Thus, we are of the view that it would be worth considering updating IAS 38 as part of a specific standard-setting project.

Presentation of unrecognised interest following the curing of a credit-impaired financial asset (IFRS 9)

In order to analyse properly the accounting treatment of the reversal of previously "suspended interests" (i.e. the difference between contractual interests and interests recognised in accordance with IFRS 9.5.4.1b), it is important to clarify how these suspended interests were initially recorded. We note the following definitions in IFRS 9:

The gross carrying amount (GCA) is "the amortised cost before adjusting for any loss allowance";

The loss allowance (LA) corresponds to the expected credit losses (ECL) that shall be measured for credit impaired financial asset "as the difference between the asset's gross carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate" (IFRS 9.B5.5.33);

The amortised cost (AC) has been defined as "the amount at which the financial asset (…) is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, (…) adjusted for any loss allowance" ;

By way of exception for financial assets that have become credit-impaired, the effective interest method applies to the AC and not to the GCA (IFRS9.5.4.1(b)).

Applying the above definitions to credit-impaired financial assets, we consider that there is no evidence that the GCA of a credit impaired asset shall reflect the contractual interests accrued instead of the interest revenue determined in accordance with IFRS 9.5.4.1(b). This is a strong assumption in the tentative agenda decision that needs to be further analysed.

Actually, IFRS 9 does not give any evidence about how "suspended interests" interact with both the GCA and the AC, and how they shall be presented either in the balance sheet or in the P&L. There are even situations where it may be impossible to comply with both (i) the interest revenue definition in IFRS 9.5.4.1 and (ii) the impairment gain or loss definition in IFRS 9.5.5.8. Assuming that on a stage 3 financial asset, the GCA has increased applying the effective interest rate; the impairment allowance should also increase to achieve interest revenue at amortised cost in the P&L (see also accompanying example in Appendix). In such case:

- either the change in impairment allowance for the period is recognised in "impairment gain or loss" but in this case the recognised interest revenue shall be based on the GCA instead of the AC to get the right final impact in the P&L; or
- interest revenue is recognised based on the AC, but in this case it is impossible to reflect in the line "impairment gain or loss" the change in impairment allowance for the period.

In our view, this inconsistency has to be clarified (via standard-setting) before addressing the way curing credit impaired financial asset should be accounted for.

Moreover, ANC considers that a loan at amortised cost that might have been temporarily credit-impaired and subsequently cured, i.e. transferred from Stage 3 to Stage 2 or fully recovered out of Stage 3, should depict the same cumulative economic return as a loan maintained in Stage 2. We also have concerns about the intelligibility of presenting a reversal that exceeds the impairment. Thus this economic return would be better reflected as an interest income than an impairment gain.

We therefore encourage the Committee to investigate further this topic in a more comprehensive way to address both the presentation on the balance sheet and on the P&L over the life of the instrument (interest revenue recognition in Stage 2 and 3, coupon payment occurring while the instrument is in Stage 3, scenario of a cured financial asset…).

Please do not hesitate to contact us should you want to discuss any aspect of our letter.

Kind regards.

Yours sincerely,

Patrick de Cambourg

Appendix: Illustrative example relating to the presentation of unrecognised interest following the curing of a credit-impaired financial asset

Contractual terms of the loan	
Yearly payment of interest	
Principal	100
EIR	10%

	31/12/N	31/12/N	31/12/ N+1	31/12/ N+2	31/12/ N+3	31/12/ N+4	Curing on 31/12/N+4
	Before impairment	After impairment					
Contractual cash flows			10	10	10	10	
Expected Cash Flows as at 31/12/N			0	0	0	**40**	
(Expectations remaining unchanged until 31/12/N+4)							
Present value of expected cash flows at the end of each period	100	27,3	30,1	33,1	36,4	40,0	

Reversal exceeds initial allowance

1) **Balance sheet - Assets : APPROACH RESULTING FROM IFRIC POSITION**

	31/12/N	31/12/ N+1	31/12/ N+2	31/12/ N+3	31/12/ N+4	total	Curing on 31/12/N+4	∑ P&L
Gross Carrying Amount (including amounts due but unpaid)	100,0	110,0	120,0	130,0	140,0		0	
loss allowance	-72,7	-79,9	-86,9	-93,6	-100,0		0	
Net amortised cost	27,3	30,1	33,1	36,4	40,0			
					71%			
Income statement						total		**∑ P&L**
Interest income (EIR)	0,0	2,7	3,0	3,3	3,6	12,7		**12,7**
Cost of risk	-72,7					-72,7	100,0	**27,3**
	-72,7	2,7	3,0	3,3	3,6	-60,0	100,0	**40,0**

2) **Balance sheet - Assets : ALTERNATIVE APPROACH**

	31/12/N	31/12/ N+1	31/12/ N+2	31/12/ N+3	31/12/ N+4	total	Curing on 31/12/N+4	∑ P&L
Gross Carrying Amount (including amounts due but unpaid)	100,0	102,7	105,7	109,0	112,7		0	
loss allowance	-72,7	-72,7	-72,7	-72,7	-72,7		0	
Net amortised cost	27,3	30,1	33,1	36,4	40,0			
					65%			
Income statement						total		**∑ P&L**
Interest income (EIR)	0,0	2,7	3,0	3,3	3,6	12,7	27,3	**40,0**
Cost of risk	-72,7					-72,7	72,7	**0,0**
	-72,7	2,7	3,0	3,3	3,6	-60,0	100,0	**40,0**