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MFRS News

Prepayment Features with Negative Compensation (Amendments to MFRS 9)

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MFRS News is your monthly update on all things relating to Malaysian Financial Reporting Standards. We'll bring you up to speed on topical issues, provide comment and points of view and give you a summary of any significant developments.

In this issue we will look at the Prepayment Features with Negative Compensation (Amendments to MFRS 9)

MASB publishes 'Prepayment Features with Negative Compensation (Amendments to MFRS 9)'

The Malaysian Accounting Standards Board (MASB) has published 'Prepayment Features with Negative Compensation – Amendments to MFRS 9' (the Amendments) that allow companies to measure particular prepayable financial assets with negative compensation at amortised cost or at fair value through other comprehensive income – instead of measuring those assets at fair value through profit or loss.

The Amendments also include clarifications to the accounting for a modification or exchange of a financial liability that does not result in derecognition.

After MFRS 9 'Financial Instruments' was issued, a request on how to apply the MFRS 9 requirements for recognising and measuring financial instruments to certain debt instruments where the borrower is permitted to prepay the instrument at an amount that could be less than the unpaid principal and interest owed was received. Such a prepayment feature is often referred to as including potential 'negative compensation' and is relatively common in a number of jurisdictions.

Under the then existing requirements of MFRS 9, a company would have measured a financial asset with such a prepayment option at fair value through profit or loss as the 'negative compensation' feature would have been viewed as introducing potential cash flows that were not solely payments of principal and interest.

However, to improve the usefulness of the information provided to users, in particular on the instrument's effective interest rate and expected credit losses for what most people would regard as debt-type assets, the MASB has issued the Amendments so that entities will now be able to measure some prepayable financial assets with negative compensation at amortised cost.

Another issue – modification or exchange of a financial liability that does not result in derecognition

Concurrent with the amendment to MFRS 9 for prepayment features with negative compensation, the MASB discussed the accounting for a modification or exchange of a financial liability measured at amortised cost that does not result in the derecognition of the financial liability. Specifically, the MASB considered whether, when applying MFRS 9, an entity should recognise any adjustment to the amortised cost of the financial liability arising from such a modification or exchange in profit or loss at the date of the modification or exchange.

The MASB concluded that no change needed to be made to the Standard itself but has clarified the existing position by adding text to the Basis for Conclusions on MFRS 9 in the Amendments.

The change to the accounting for a modification or exchange of a financial liability that does not result in derecognition is effective from 1 January 2018 as this text merely clarifies the existing Standard as opposed to amending it.

To summarise, the MASB believes that MFRS 9 already provides an adequate basis for an entity to account for modifications and exchanges of financial liabilities that do not result in derecognition. The text which has been added in the Amendments highlights that the requirements in MFRS 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. Those requirements state that when contractual cash flows of a financial asset are renegotiated or otherwise modified and the renegotiation or modification does not result in the derecognition of that financial asset, an entity shall recalculate the gross carrying amount of the financial asset and shall recognise a modification gain or loss in profit or loss.

Ironically, the 'other issue' clarifying the accounting for a modification or exchange of a financial liability that does not result in derecognition may well result in the most significant change in accounting as modification gains and losses will now be recognised immediately in profit or loss in such situations.

'Prepayment Features with Negative Compensation (Amendments to MFRS 9)' is effective for annual reporting periods beginning on or after 1 January 2019, with earlier application permitted. However, the text which has been added to clarify the accounting for a modification or exchange of a financial liability that does not result in derecognition is effective for annual reporting periods beginning on or after 1 January 2018 (ie the effective date of MFRS 9 itself) as this text merely clarifies the existing Standard rather than amending it.

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