ICAG/EB/2/25

4TH ICAG DISCUSSION PAPER

Guidelines on the Financial Reporting Implications of the Government of Ghana Eurobond Restructuring Program (GGERP)

1.0

BACKGROUND AND INTRODUCTION

1.1 BACKGROUND

On June 24, 2024, the Government of Ghana (GoG) announced an Agreement in Principle (AIP) with Eurobond holders (the International Steering Committee and Regional Steering Committee, together referred to as Steering Committees) to restructure approximately $13.1 billion of its external debt. This restructuring, guided by financial advisors Lazard Frères and legal advisors Hogan Lovells, aims to alleviate Ghana's debt burden and support economic recovery in line with the IMF-supported program. On October 3, 2024, The Ministry of Finance announced the successful completion of the Eurobond debt exchange, highlighting a 37% reduction in the nominal value of Ghana's debt and substantial debt service savings during the IMF program. The new bonds were issued to participating bondholders on October 9, 2024, finalizing the exchange process and marking a significant step toward restoring Ghana's debt sustainability.

Among others, bondholders were presented with two distinct options for restructuring their holdings:

1. Par Option: This option involved no reduction in the principal amount (no nominal haircut). Bondholders opting for this choice received new bonds with a lower interest rate of 1.5% and extended maturities, with repayments scheduled up to 2037.

2. Disco Option: Under this option, bondholders accepted a 37% reduction in the principal amount (nominal haircut). In return, they received new bonds with higher interest rates ranging from 5% to 6% and shorter maturities, with repayments occurring between 2029 and 2035.

There are other non-financial terms attached to the AIP and they are:

a. GoG will provide a semi-annual updates or disclosure on public debt levels to increase transparency.

b. GoG will ensure Eurobond holders receive equal treatment relative to other creditors.

c. The AIP allows bondholders to regain some losses if Ghana's economic performance significantly improves.

d. GoG will reinstate the Fiscal Responsibility Act, setting a deficit limit of 5% of GDP to promote fiscal discipline and sustainability. This would ensure economic stability and enhance investor confidence.

Additionally, both options provided bondholders with compensation for interest payment arrears up to December 2023, issued in the form of Post-Default Interest (PDI) Notes.

1.2 CONTEXT AND OBJECTIVES OF THIS DISCUSSION PAPER

ICAG has issued prior discussion papers on the Domestic Debt Exchange Programme for local currency assets. We recognise that a number of the issues raised in the previous discussion papers and discussed are applicable to the Eurobond Exchange. This paper has been prepared to highlight key and specific financial reporting implications of the Eurobond Exchange based on the content of the Exchange Offer and Consent Solicitation Memorandum. Key issues discussed in this paper include the following:

i. Whether or not the Eurobond Exchange results in a substantial modification of the old Eurobonds and how these should be accounted for and

ii. How to determine the fair value of the new Bond.

1.3 EXCLUSIONS

i. This discussion paper only focuses on the financial reporting implications **(IFRS 13 – Fair Value Measurement and IFRS 9 – Financial Instruments)** of the Eurobond Exchange and does not cover any tax and legal implications

ii. The matters raised in this discussion paper are our interpretations of the relevant accounting standards on the Eurobond Exchange at high level based on information currently available publicly.

iii. No responsibility to any third party is accepted as the report has been prepared solely for the purpose of sharing our perspectives on the financial reporting implications of the Eurobond Exchange as currently disclosed.

2.0

DISCUSSIONS

2.1 WHETHER OR NOT THE EUROBOND EXCHANGE RESULTS IN A SUBSTANTIAL MODIFICATION OF THE OLD EUROBONDS AND HOW THESE SHOULD BE ACCOUNTED FOR

- Under the Agreement for the Eurobonds, Bondholders would forego approximately $4.7 billion of their claims and provide cash flow relief of approximately $4.4 billion during the IMF program period.

- All holders have the choice between the PAR and DISCO option, up to a limit of US$ 1.6 billion for the PAR option. In case a consenting holder chooses the DISCO option, such consenting holder would receive 4 new instruments (Bond Short, Bond Long, Down Payment Bond and PDI Bond). Otherwise, such consenting holder would receive a Par Bond.

- In addition to that, any consenting holder (under both options) would receive a PDI bond and a consent fee.

IFRS 9.3.3.2 provides for de-recognition of financial assets/liabilities stating that an exchange between an existing borrower and lender of debt instruments with substantially different terms or a substantial modification of the terms of an existing financial liability shall be accounted for as an extinguishment of the original financial liability

Referencing this standard, we are of the opinion that substantial modification has occurred due to the following:

1. As presented in the Exchange Offer and Consent Solicitation Memorandum, the existing bonds carried a minimum of 6.375% coupon and maximum of 10.75% coupon (with 1 zero coupon bond) with majority of the bonds averaging about 8% coupon. These are expected to be exchanged for 1.5%, 5% and 6% coupon bonds.

2. With exception of 4 out of the 15 bonds, the existing bonds had longest maturity date of 2035 with some bonds having maturity dates as early as 2023. These are expected to be exchanged for new bonds with maturities extending to 2037.

3. A holder of a single bond or a holder of portfolio of bonds will receive, in exchange for the existing bond or portfolio of existing bonds, either a DISCO or a PAR option in accordance with the terms and conditions of the Exchange Offer and Consent Solicitation Memorandum.

4. Under a PAR option, existing bonds will be exchanged for 3 new bonds including Bond Par, Down Payment Bond and PDI Bond.

5. Under a DISCO option, existing bonds will be exchanged for 4 new bonds including Bond Short, Bond Long, Down Payment Bond and PDI Bond with up to 37% haircut.

6. Upon selection of an option, all of the bondholders are to receive the same restructuring deal irrespective of the terms and conditions of their individual holdings. This indicates that the individual instruments, terms and conditions were not taken into account. The different bonds were not each modified in contemplation of their respective terms and conditions but were instead replaced by a new uniform debt structures of 5 bonds.

Consequently, we expect that the old assets be derecognised, and a new asset recognised for the new bonds.

2.2 HOW TO DETERMINE THE FAIR VALUE OF THE NEW BOND

It is important to note that in accordance with IFRS 13, the transaction price remains an important piece of objective evidence for measuring fair value at initial recognition. In many cases, the transaction price (excluding transaction costs) equals fair value - **[IFRS 13 Paragraph 58 "In many cases the transaction price will equal the fair value (e.g. that might be the case when on the transaction date the transaction to buy an asset takes place in the market in which the asset would be sold)"].** However, there may be situations in which the transaction price may not be representative of fair value. One of such situation is if the transaction takes place under duress or a party is forced to accept the price in the transaction. **[IFRS 13 Paragraph 59 "When determining whether fair value at initial recognition equals the transaction price, an entity shall take into account factors specific to the transaction and to the asset or liability. Paragraph B4 describes situations in which the transaction price might not represent the fair value of an asset or a liability at initial recognition"] – [Paragraph B4 (b) "the transaction takes place under duress or the seller is forced to accept the price in the transaction. For example, that might be the case if the seller is experiencing financial difficulty".]**.

The exchange was conducted on terms that bondholders would not ordinarily consider, including taking significant haircuts, accepting extended maturities, and agreeing to reduced coupon rates. Furthermore, the Government had been in default on its Eurobonds since December 2022, and the alternative to accepting the exchange was the continued non-payment of the Government's obligations under the existing Eurobonds. Based on this information, the Institute is of the view that the transaction price does not reflect fair value.

According to IFRS 13, the overall outcome of fair valuation should be to estimate a price at which market participants will exchange the asset **[IFRS 13 Appendix B2 "the objective of a fair value measurement is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions"].** It is for this reason the standard emphasises the use of observable market input as much as possible. [IFRS 13 Paragraph 36 "In all cases, an entity shall maximise the use of relevant observable inputs and minimise the use of unobservable inputs to meet the objective of a fair value measurement, which is to estimate the price at which an orderly transaction to transfer the liability or equity instrument would take place between market participants at the measurement date under current market conditions". Thus fair valuation should be based on available market data adjusted to reflect the special consideration received, where applicable. However, In the peculiar case of Ghana, due to limited market activity and unreliable secondary market pricing, Ghana's Eurobonds must be valued using internal models based on expectations of future cash flows and risks. On the measurement date, no identical transaction was actively observed or traded. However, we saw some few (insignificant) trades subsequently.

On the measurement date, no similar transaction(s) (from Mozambique or Zambia Eurobonds) was actively observed or traded. There is also no readily available data on credit spreads/default risk premium on Mozambique and Zambia. Besides, even if that existed, obviously the credit spreads for these countries may significantly differ given that the defaults and restructuring happened at different time periods (Mozambique restructured in 2019, Zambia restructured in 2024 but Ghana restructured in 2023) and the dynamics of the restructuring and economic conditions also differ.

Market yield curves for African sovereign bonds may not accurately reflect Ghana's unique risk profile.

Currently, Ghana's Eurobonds trade over-the-counter (OTC) in fragmented and often illiquid secondary markets, meaning there is no active exchange with reliable pricing. Market trades for Ghana's bonds are sporadic, and bid-ask spreads are wide, indicating low market liquidity.

Key unobservable inputs to consider may include: Probability of default (PD): Estimated based on Ghana's fiscal stability and IMF support, expected recovery rate: which is generally derived from restructuring terms (in our case about 63% after the haircut), Liquidity risk premium, inflation risk, etc.

2.2.1 FAIR VALUATION OF BONDS USING UNOBSERVABLE MARKET DATA

Fair valuation of bonds using unobservable market data (Level 3 inputs under IFRS 13) requires careful estimation and adherence to IFRS 9 (Financial Instruments) and IFRS 13 (Fair Value Measurement). The following steps outline the process:

Step 1: Identify the Bond's Characteristics

- **Bond Type** (fixed rate, floating rate, zero-coupon, convertible, etc.)

- **Issuer's Credit Quality**
- **Maturity Date**
- **Coupon Payments**
- **Call/Put Options (if applicable)**

Step 2: Determine the Fair Value Hierarchy Level

• IFRS 13 classifies inputs into three levels:

o Level 1: Quoted prices in active markets.

o Level 2: Observable market data, such as interest rates or credit spreads.

o Level 3: Unobservable inputs (used when Level 1 & 2 inputs are unavailable).

• **If observable market data is unavailable, Level 3 inputs must be used.**

Step 3: Select an Appropriate Valuation Technique

IFRS 13 requires an entity to use valuation techniques that maximize observable inputs and minimize unobservable inputs. Common models include:

• **Discounted Cash Flow (DCF) Model** (most widely used)

• **Comparable Market Approach** (if similar instruments are traded)

• **Option Pricing Models** (for bonds with embedded derivatives)

Step 4: Estimate Key Inputs for the Model

Since Level 3 inputs involve unobservable data, reasonable estimates must be used:

• **Discount Rate Estimation:**

o Use a risk-free rate (e.g., government bonds of similar maturity).

o Adjust for credit risk (issuer's estimated credit spread).

o Include liquidity risk and market conditions.

- **Credit Spread Estimation:**
    - o Infer from issuer's credit rating and similar bond issues.
    - o Use CDS (Credit Default Swap) spreads as a proxy if available.
    - o Consider industry benchmarks.
- **Liquidity and Risk Premiums:**
    - o Adjust for market illiquidity and specific risks not reflected in observable data.

Step 5: Perform the Valuation

- Apply the estimated inputs in the selected valuation model (e.g., DCF).
- Calculate the present value of future cash flows using the derived discount rate.

Step 6: Sensitivity Analysis

- Assess the impact of changes in key assumptions (discount rate, credit spread, liquidity premium).
- Perform scenario testing to understand potential valuation volatility.

Step 7: Assess Model Validation and Reasonableness

- Compare results with any available secondary sources (e.g., analyst reports, private transactions).
- Ensure the valuation methodology is consistent with industry best practices.

Step 8: Disclose Key Assumptions and Judgments (IFRS 13)

IFRS 13 requires extensive disclosure for Level 3 valuations:

- **Key assumptions and valuation techniques used.**
- **Sensitivity of fair value to changes in inputs.**
- **Reconciliation of opening and closing fair value measurements.**
- **Justification for using unobservable inputs.**

Step 9: Apply IFRS 9 Measurement and Impairment Testing

- **Classification:** If held at Fair Value Through Profit or Loss (FVTPL) or Fair Value Through Other Comprehensive Income (FVOCI), apply fair valuation.
- **Impairment:** Even for fair-valued bonds, IFRS 9 requires Expected Credit Loss (ECL) assessment.

Step 10: Ensure Audit and Governance Review

- Review with external auditors.
- Document all assumptions, methodologies, and judgments for compliance purposes.

Losses are deferred and amortized over the tenor of the instrument. Following these steps ensures compliance with IFRS 9 and IFRS 13 while appropriately valuing bonds using unobservable market data.

APPROPRIATE VALUATION TECHNIQUE (INCOME APPROACH)

We suggest the Income approach using the Discounted Cash Flow (DCF) method to be used as the best alternative approach for fair valuing the new Eurobonds due to the following reasons:

• The principal and coupon cash flows from the instrument can be readily ascertained

• The discount rate estimation could be assessed using Ghana's risk-adjusted borrowing cost and sovereign credit or base borrowing rate using the US long-term treasuries plus risk premiums.

The following variables in estimating the market discount rate have been proposed for use in valuing Ghana's Eurobonds:

• **Base Rate (U.S. Risk-Free Rate):** Since Ghana's Eurobonds are denominated in U.S. dollars (USD), the valuation starts with a risk-free rate based on U.S. 10-year Treasury yields.

• **Sovereign Credit Spread (Default Risk Premium):** Ghana's sovereign credit risk premium reflects the additional return required by investors due to the possibility of default. The spread between the 2024 yield on the 10-year US Treasury and the weighted average of yields on GOG Eurobonds issued between 2018 and 2021.

• **Liquidity Premium (Marketability Risk):** Due to Ghana's restructuring, its Eurobonds lack liquidity as trading of these investments may be slow.

• **Inflation and Country Risk Premium:** Ghana's macroeconomic instability, including high inflation, currency depreciation, and political risks, affects investor return expectations.

Based on the parameters above, the discount rates range from 8% to 11% depending on the percentage point within the range where liquidity and country risk premium is assessed.

This range compared reasonably to other modelled market yields quoted by Bloomberg, Bondblox, Refinitiv, etc as follows:

Module 1

Based on the treatment of the consent fee and special consideration the price will change.h However, the discount rate is 11.29% in each approach

BOND	Carrying Amount	Fair Value	Day One Loss	Bloomberg
Bond Short	242	216.02	25.98	87.40
Bond Long	348	259.65	88.35	71.77
PDI Bond	14	10.88	3.12	77.10
Down Payment bond	40	36.84	3.16	91.77
	644	523.39	120.61	

Module 2

Source	PAR	DISCO LONG	PDI	DISCO SHORT	DPB
Bloomberg Yield	10.16	10.79	11.39	10.14	11.60
Bondblox Yield	9.59	10.92	10.38	10.19	9.29
Refinitive Yield	9.68	9.27	5.07	8.26	4.79
Average	9.81	10.33	8.95	9.53	8.56
Maturity Date	03/01/2037	03/07/2035	03/01/2030	03/07/2029	03/07/2026

Module 3

The yields were derived from the median prices from three pricing vendors on the 10th of October 2024 adjusted for the special consideration cash flows. Pricing vendors used were Bloomberg, ICE, S&P Global, Refinitiv and Pricing Direct. The sources are based on which pricing vendors have prices close to each other. So the three vendors referred above could be a combination of any of the five pricing vendors used for each bond.

BOND	Price	Yield
Disco Long	74.55	11.34
Disco Short	90.80	1059
PDI Bond	76.5	11.77
Down Payment Bond	91.26	11.39

ISSUED BY

P. KWASI AGYEMANG, FCA
CHIEF EXCUTIVE OFFICER

ON BEHALF OF THE INSTITUTE
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