



National Asset
Management Agency



7 February 2012

Mr. Ted McEnery,
Clerk,
Committee of Public Accounts,
Leinster House,
Dublin 2.

Dear Mr. McEnery,

Thank you for your letter of 25th January following my response to the Committee of 13th December which provided additional information in respect of the particular matters raised following NAMA's appearance before the Committee on 26th October.

IFRS accounting is complex, and I do hope the enclosed response with an illustrated example and my previous responses answers the query raised.

Yours sincerely,

Brendan McDonagh
Chief Executive Officer

Responses to issues raised

1. Loan interest

How much of the €448m interest recognised in the NAMA accounts was received in cash during the year and how much was not paid and is still outstanding?

As previously explained, the €448m interest income recognised in the NAMA accounts during 2010, was based on the Effective Interest Rate (EIR) methodology. The EIR methodology is an accounting technique which NAMA is required to adopt for the recognition of interest income on its loan portfolio in accordance with International Financial Reporting Standards (IFRS).

The EIR method allocates income proportionately over the life of a loan regardless of the timing of cash receipts. The €448m recognised as income in NAMA's accounts reflects the expected rate of return on NAMA's acquired loans based on their expected future cash receipts over the life of the loans.

The position for the majority of NAMA loans is that NAMA ultimately expects to realise the value of the loans it has acquired through the future disposal of the underlying property collateral. As a result, in many cases the accounting income on the loan is recognised based solely or mainly on the disposal of the property collateral, without any cash being received until those disposals occur. I have set out an example in the Appendix of how the accounting income is recognised on a loan of this type, in accordance with the EIR methodology as prescribed under IFRS.

NAMA received €734m from borrowers which included the sale of property of €363m and other loan cash receipts of €371m. Based on further analysis of cash received from individual NAMA debtors we have estimated that €313m of the €448m of interest recognised under IFRS could be categorised as interest received in the period. Please note that the difference is not 'due to be paid this year', nor is it 'rolled up' interest, as the EIR interest is an accounting allocation of income required by IFRS. It is simply a timing difference between expected cash receipts and the allocation of interest income over the life of the loan. In fact as previously explained the first €448m of the €734m of cash received for 2010 is allocated against interest receipts with the remainder being allocated against the principal balance.

I have also previously explained that the interest in the NAMA accounts differs significantly from the interest that the borrower contractually owes NAMA. While the NAMA debtor continues to be liable for interest accruing on the original par value of the loan, IFRS accounting standards do not permit NAMA to use this as a basis to recognise interest income on its loan portfolio for the purpose of financial reporting. This is purely the accounting policy applied on income recognition which has been given an unqualified audit opinion by the C&AG for the 2010 accounts.

NAMA – Annual Report and Financial Statements 2010

Appendix – EIR example

An example is given below of a loan acquired for €100 which it is expected will realise €120, five years hence, to illustrate the recognition of income over the life of a loan in accordance with the effective interest rate (EIR) methodology

Example EIR Rate						
Year	2010	2011	2012	2013	2014	2015
Loan Carrying Value	100					
Estimated Cash flows	0	0	0	0	0	120
EIR Rate	3.71%					

Based on estimated future cash flows an EIR rate of 3.71% is derived being the internal rate of return assuming the realisation of €120 in 5 years time.

This rate is then applied to the carrying value of €100 to allocate the return on the asset to interest income over 5 years. While no cash is received in years 1-4, interest income will continue to be recognised in profit and loss on an accounting basis in accordance with the EIR methodology.

Income recognised - Year 1 - 5

	Opening balance	Interest recognised	Expected Cash flows	Closing balance
Year 1	100.00	3.71	0.00	103.71
Year 2	103.71	3.85	0.00	107.57
Year 3	107.57	3.99	0.00	111.56
Year 4	111.56	4.14	0.00	115.70
Year 5	115.70	4.30	-120.00	0.00