# STAFF PAPER

October 2019

## IASB® meeting

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| **Project** | **IBOR Reform and its Effects on Financial Reporting – Phase 2** | | |
| Paper topic | Classification and measurement – modification of financial instruments | | |
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## Introduction

1. The purpose of this paper is to discuss the assessment of whether a change in the contractual cash flows or terms is a substantial modification of a financial instrument and the accounting requirements for modifications that are not substantial (ie do not result in derecognition of a financial instrument when applying IFRS 9 *Financial Instruments*). More specifically, this paper focuses on changes to contractual terms that might occur in the context of interest rate benchmark reform (IBOR reform).

2. As discussed at the September 2019 Board meeting, the scope of Phase 2 is broader than the previous phase as it will encompass different areas of accounting for financial instruments and could also include other areas of accounting. However, this does not mean that all those accounting issues will result in amendments to IFRS Standards to provide relief through exceptions to existing requirements. In particular, when IFRS Standards provide an adequate basis to account for a particular issue and the accounting outcome results in useful information to users of financial statements by faithfully representing the

economic effects of IBOR reform, the staff do not believe that any amendments to current IFRS Standards are needed.

3. This paper is structured as follows:

   (a) Summary of staff recommendations (paragraph 4);

   (b) Background (paragraphs 5–9);

   (c) Current guidance on modifications of financial instruments (paragraphs 10–12);

   (d) What is a modification of a financial instrument? (paragraphs 13–15);

   (e) How to determine whether a modification is substantial (paragraphs 16–24);

   (f) Modifications related to the reform (paragraphs 25–42);

   (g) Order in which modifications should be accounted for (paragraphs 43–46); and

   (h) Question to the Board (page 19).

## Summary of staff recommendations

4. In this paper the staff recommend that the Board:

   (a) amend IFRS 9 to clarify that even in the absence of an amendment to the contractual terms of a financial instrument, a change in the basis on which the contractual cash flows are determined that alters what was originally anticipated constitutes a modification of a financial instrument in accordance with IFRS 9 (refer to paragraph 15).

   (b) amend IFRS 9 to provide examples of modifications that are substantial and that are not substantial from a qualitative perspective (refer to paragraphs 22–24) .

   (c) amend IFRS 9 to provide a practical expedient allowing entities to apply paragraph B5.4.5 of IFRS 9 to account for modifications related to the reform. Examples of modifications that are related to the reform and those that are not (as set out in paragraphs 39–40), should also be provided in IFRS 9 (see paragraphs 36–41).

(d) amend IFRS 9 to clarify that an entity should first apply paragraph B5.4.5 of IFRS 9 to account for modifications related to reform to which the practical expedient applies. Thereafter, an entity should apply the current IFRS 9 requirements to determine if any other modifications are substantial and, if those modifications are not substantial, the entity should apply paragraph 5.4.3 of IFRS 9 (see paragraph 45–46).

## Background

5. As already acknowledged by the Board during Phase 1 of the IBOR project, the replacement of the interest benchmark rate with an alternative benchmark rate will require bilateral negotiation with counterparties in many instances, which will require significant time and effort from most entities

6. Based on the feedback received and the research done by the staff about the potential effects of IBOR reform, it is expected that changes to contractual terms and contractual cash flows of financial instruments could be made in a number of ways, including but not limited to:

   (a) replace the existing interest rate benchmark with, or to include reference to, an alternative benchmark rate;

   (b) amend the period and frequency at which the benchmark rate is reset;

   (c) insert 'fallback clauses' into contracts to specify the hierarchy of rates to which an interest rate benchmark could revert in case the existing benchmark rate cease to exists; and

   (d) amend other contractual terms such as the maturity date, loan amount or credit spread.

7. This paper discuss the assessment of whether a change in the contractual cash flows or terms is a substantial modification of a financial instrument and the accounting requirements for modifications that are not substantial (ie do not result in derecognition of a financial instrument when applying IFRS 9). Agenda Pager 14B *Accounting implications from the derecognition of a modified financial instrument* for this meeting discusses the accounting implications from the derecognition of a financial instrument following a substantial modification.

8. The staff acknowledge the view expressed by the Interpretations Committee (the Committee) in November 2015 about the broad scope of a project to provide additional guidance to determine when a modification of a financial instrument result in derecognition. However, the objective for Phase 2, as discussed in the September 2019 meeting, is '*to provide useful and relevant financial information about the effects of the transition to alternative benchmark rates on an entity's financial statements*', while at the same time supporting preparers in applying the requirements of the IFRS Standards during IBOR reform. Such an objective is intended to assist the Board in defining the scope of potential issues to be considered during Phase 2 and assessing whether it should take any action in the form of amendments to IFRS Standards. In light of this, the staff consider that the scope of any guidance to be provided should be limited to modifications that are made in the context of IBOR reform.

9. In considering whether any additional guidance or relief from the current accounting requirements are needed with regards to IBOR reform, the staff have identified the following three questions to be resolved:

   (a) what is a 'modification' of a financial instrument?

   (b) how to determine whether a modification is substantial?

   (c) should modifications that do not result in derecognition be accounted for by adjusting the EIR or recognising a modification gain or loss?

## Current guidance in IFRS 9 on modifications of financial instruments

10. With specific reference to the modification of contractual terms of financial assets, financial liabilities and embedded derivatives, IFRS 9 includes the following guidance:

    (a) Paragraph 3.3.2 states that a substantial modification of the terms of a financial liability shall be accounted for as the extinguishment of the original financial liability and the recognition of a new financial liability.

    (b) Paragraph 5.4.3 states that when the contractual cash flows of a financial asset are renegotiated or otherwise modified and such modification does not result in derecognition, the gross carrying amount of the financial asset shall be recalculated as the present value of the modified contractual cash flows discounted at the original effective interest rate (EIR) and a modification gain or loss recognised in profit or loss.

(c) Paragraph B3.3.6 states that the terms of a financial liability are substantially different if the discounted cash flows under the new terms are at least 10 per cent different from the discounted remaining cash flows of the original financial liability.

(d) Paragraph B4.3.11 states that the subsequent reassessment of embedded derivatives is not permitted, unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required.

11. In addition to the above guidance, several requests for clarification and/or additional guidance on modifications have been submitted to the IFRS Interpretations Committee (the Committee), most notably the following:

(a) September 2012 – on the question about the Greek Government Bonds, the Committee concluded that, by analogy to the guidance on financial liabilities, a substantial change to the terms of the bonds would result in derecognition[1];

(b) November 2015 – the Committee received a request for more generic guidance on modifications but decided not to pursue the matter as the Committee was of the view that the nature of the matter was very broad and that it will not be able to address it through an Interpretation[2]; and

(c) May 2016 – the Committee received a request to clarify which fees and costs should be included when performing the ‘10 per cent test’ and

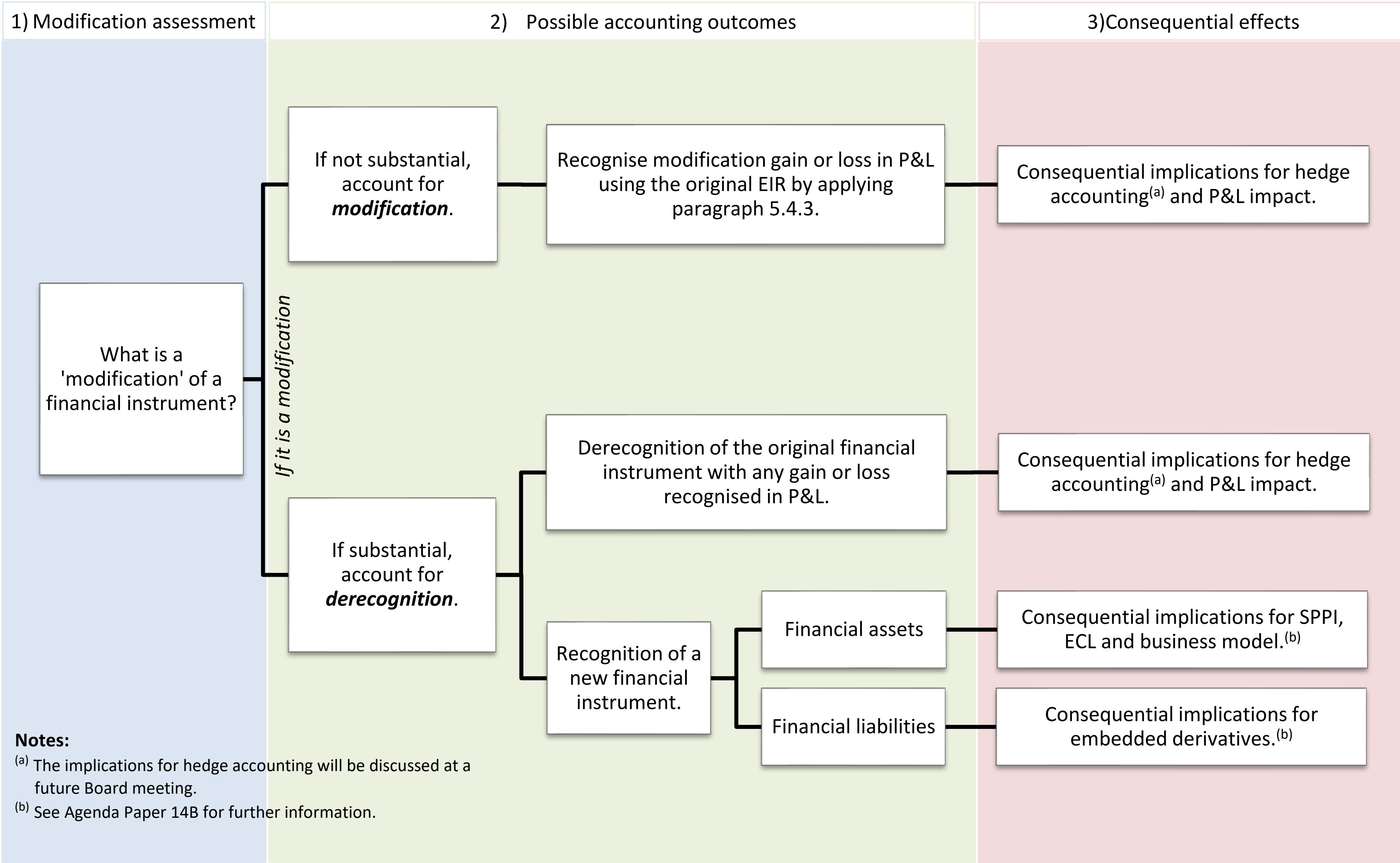
[1] At its September 2012 meeting, the Committee noted that, in the absence of an explicit discussion of when a modification of a financial asset results in derecognition, entities could develop an analogy to the notion of a substantial change of the terms of a financial liability.

[2] For further information, refer to the November 2015 IFRS IC Agenda Paper 4 *Derecognition of modified financial assets*.

concluded that only fees paid or received between the lender and borrower (or on their behalf) should be included[3].

12. Whether a modification is substantial or whether it is accounted for as an adjustment to the EIR as opposed to a modification gain or loss will have consequential effects on other areas such as hedge accounting (including accounting for the end of Phase 1 relief), SPPI and business model assessments, measurement of expected credit losses and assessment of embedded derivatives. To illustrate the staff's thought process in analysing these matters and understanding the interaction between these areas, we have included the following flowchart summarising the current requirements in IFRS 9:

[3] For further information, refer to the September 2016 IFRS IC Agenda Paper 9 *IFRS 9 Financial Instruments and IAS 39 Financial Instruments: Recognition and Measurement—Fees and costs included in the '10 per cent' test for the purpose of* derecognition.




**Notes:**

[a] The implications for hedge accounting will be discussed at a future Board meeting.

[b] See Agenda Paper 14B for further information.

## What is a modification of a financial instrument?

13. In most cases, determining whether a modification of a financial instrument has occurred will be straight forward, eg when the original contractual terms of a financial instrument are amended to replace the existing interest rate benchmark with an alternative benchmark, for example by replacing the reference to LIBOR with a reference to SONIA. However, in other cases, there could be no change to the terms written in the contract, but there could instead be a change in the calculation methodology of an interest rate benchmark that modifies the basis for determining a financial instrument's contractual cash flows. For example, this would be the case when the calculation methodology of a term rate becomes based on an overnight rate or the calculation methodology is otherwise altered from what it was before. Although the contractual terms of the financial instrument have not been amended to replace the contractual interest rate benchmark, the change in calculation methodology has modified the contractual cash flows of that financial instrument.

*Staff view*

14. IFRS 9 does not define 'modifications of financial instruments'.[4] However, as noted in paragraph 10 of this paper, paragraph 5.4.3 of IFRS 9 refers to modification or renegotiation of the contractual cash flows of a financial asset, while paragraph 3.3.2 of IFRS 9 refers to modification of the terms of an existing financial liability. Although these paragraphs of IFRS 9 use slightly different wording, both refer to the fact that the contractual terms or cash flows are amended in a way not originally intended when entering into the contract.

15. Therefore, in light of the IBOR reform, the staff recommend that IFRS 9 should be amended to clarify that, even in the absence of an amendment to the contractual terms of a financial instrument, a change in the basis on which the

[4] This was also observed in paragraph 42 of the November 2015 IFRS IC Agenda Paper 4 *Derecognition of modified financial assets*, when the Committee discussed whether it should consider a potential project to clarify the guidance in IFRS 9 about when a modification or exchange of financial assets results in the derecognition of the original asset.

contractual cash flows are determined that alters what was originally anticipated, constitutes a modification of a financial instrument in accordance with IFRS 9.

### How to determine whether a modification is substantial

16. As noted in paragraph 10 of this paper, paragraph 3.3.2 of IFRS 9 already states that modifications that result in terms that are substantially different from the original terms result in the derecognition of the original financial liability.

17. To determine when a modification of a financial liability results in substantially different terms from a quantitative perspective, paragraph B3.3.6 of IFRS 9 provides further guidance, commonly referred to as the '10 per cent test':

> For the purpose of paragraph 3.3.2, the terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10 per cent different from the discounted present value of the remaining cash flows of the original financial liability. […]

18. With respect to financial assets, according to paragraph B5.5.25 of IFRS 9, in some circumstances, the renegotiation or modification of the contractual cash flows of a financial asset can lead to the derecognition of the existing financial asset. However, no further guidance is given in this regard.

19. In the absence of specific guidance in IFRS 9 related to financial assets, the Committee noted, at its September 2012 meeting, that (in the absence of a transfer) entities could develop an analogy to the notion of a substantial change of the terms of a financial liability, on the grounds of IAS 8: *Accounting Policies, Changes in Accounting Estimates and Errors*. For example, these entities could analogise to paragraphs 3.3.2 and B3.3.6 of IFRS 9, which refers to financial liabilities.[5]

[5] In analysing the specific fact pattern submitted, the Committee noted that an entity should either assess the transaction against paragraph 18 of IAS 39 (now paragraph 3.2.4 of IFRS 9 ie the contractual rights to the cash flows from the financial asset are transferred) or develop of an analogy to the notion of a substantial change of the terms of a financial liability in paragraph 17(a) of IAS 39 (now paragraph 3.2.3 of IFRS 9).

20. As noted in paragraph 17 above, in applying the ‘10 per cent test’ a modification is considered substantial when the net present value of the cash flows under the new terms differs by at least 10 per cent from the present value of the remaining cash flows under the original terms. Thus, if the difference is lower than 10 per cent, entities would still look at other factors for the purpose of assessing whether a modification is substantial. IFRS 9 does not provide specific guidance about when modifications to the terms of financial assets or liabilities might be substantial on a qualitative basis. Based on the feedback received from stakeholders in the context of IBOR reform, this is an area where additional guidance would assist in determining whether a change in contractual terms is substantial enough, from a qualitative perspective, to require derecognition of financial assets and financial liabilities. In addition, based on input gathered from research activities as well as the feedback received from the Accounting Standards Advisory Forum (ASAF) at its October 2019 meeting, the issues arising from the modification of financial instruments to be based on an alternative benchmark should be addressed as a priority given the timing of IBOR reform and current uncertainty around when contracts will start being amended. The feedback received from the ASAF is consistent with the objective of the Phase 2 noted in paragraph 8 of this paper, ie to focus on issues arising from IBOR reform.

*Staff view*

21. The staff note that determining whether the terms are substantially different from a qualitative perspective will depend on the specific facts and circumstances of each case. This is because modifications to the basis for determining a financial instrument’s cash flows can vary significantly across jurisdictions, product types and agreements. The staff therefore considered whether it would be possible to provide some examples of modifications that would be deemed substantial on a qualitative basis and those that would not.

22. For example, modifications that would be considered substantial from a qualitative perspective are those that result in a significant value transfer and/or a new underwriting/pricing assessment of the financial instrument, including:

    (a) modifications to the currency on which the financial instrument is denominated

(b) a significant extension of the maturity date;

(c) modifications to a floating-rate financial instrument so that if becomes a fixed rate financial instrument; and

(d) modifications to contractual cash flows that would cause a financial asset that passed the solely payments of principle and interest assessment (SPPI) before to fail that assessment because of the modifications.

23. Examples of modifications that would not result in substantial modifications from a qualitative perspective are those that do not result in a significant value transfer or a new pricing/ underwriting assessment, including:

(a) modifications to replace the current interest rate benchmark with an alternative benchmark rate that is economically equivalent; and

(b) modifications to the timing and frequency with which the benchmark rate is reset.

24. However, the staff consider it important to emphasise that these examples are not exhaustive and the underlying principle remains to assess whether a modification to contractual cash flows or contractual terms result in an instrument that is substantially different from the original financial instrument or that in effect is an extinguishment of the original financial instrument.

## Modifications related to the reform

25. Modifications related to the reform are those that will result in changes to the interest rate benchmark, on which a financial instrument's contractual cash flows are based, on an economically equivalent basis. In assessing the accounting implications from these modifications, we considered whether:

(a) IFRS 9 provides an adequate basis to determine how to account for modifications related to the reform; and

(b) the accounting outcome would meet the objectives of Phase 2.

*Does IFRS 9 provide an adequate basis to determine how to account for modifications related to the reform?*

26. Paragraph 5.4.3 of IFRS 9 applies to renegotiations and other modifications of financial assets that do not result in derecognition, and states that:

> When the 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 in accordance with this Standard, an entity shall recalculate the gross carrying amount of the financial asset and shall recognise a modification gain or loss in profit or loss. The gross carrying amount of the financial asset shall be recalculated as the present value of the renegotiated or modified contractual cash flows that are discounted at the financial asset's original effective interest rate. […]

27. The accounting for modified financial liabilities that do not result in derecognition mirrors that of modified financial assets. In particular, paragraph BC 4.253 of IFRS 9 states that:

> […] the requirements in IFRS 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.

28. Following a modification of a financial asset or financial liability that does not result in derecognition, the modification gain or loss is determined by recalculating the gross carrying amount of the financial asset or financial liability by discounting the modified cash flows using the original effective interest rate. Any modification gain or loss is immediately recognised in the statement of profit or loss.

29. However, regarding the application of the effective interest rate method for floating-rate financial instruments, paragraph B5.4.5 of IFRS 9 states that periodic

re-estimation of cash flows to reflect the movements in the market rates of interest alters the effective interest rate:

> For floating-rate financial assets and floating-rate financial liabilities, periodic re-estimation of cash flows to reflect the movements in the market rates of interest alters the effective interest rate. If a floating-rate financial asset or a floating-rate financial liability is recognised initially at an amount equal to the principal receivable or payable on maturity, re-estimating the future interest payments normally has no significant effect on the carrying amount of the asset or the liability.

30. Therefore, the question that arises is whether the modification of a floating-rate financial instrument to replace IBOR with an alternative benchmark rate should be considered within the scope of the requirements in paragraph B5.4.5 of IFRS 9 (ie update of the EIR without adjustments to the carrying amount) or paragraph 5.4.3 of IFRS 9 (ie recalculation of the carrying amount of the financial instrument). The difference between these two views can be summarised as follows:

    (a) If paragraph B5.4.5 of IFRS 9 is applied, the replacement of IBOR with an alternative benchmark is akin to altering the EIR for a movement in market rates. Revising the EIR would not have any effect on profit or loss at the date of modification. In essence, this would be the same as treating the alternative benchmark rate as if it was the continuation of the original interest rate benchmark.

    (b) If paragraph 5.4.3 of IFRS 9 is applied, the replacement of IBOR with an alternative benchmark would be accounted for by recalculating the carrying amount (ie a modification of the financial instrument). This is because the replacement of IBOR has altered the basis for determining the contractual cash flows of the financial instrument and, therefore, could not be considered as a 'movement' in IBOR as originally specified in the contract. For the purpose of determining the modification gain or loss, the original effective interest rate (based on IBOR) should be used to discount the modified cash flows (based on the alternative benchmark) when calculating the carrying amount. Any resulting modification gain or loss should be recognised in profit or loss.

31. The staff note that, based on the current requirements in IFRS 9, the reform or replacement of an interest rate benchmark is not a ‘movement in market rates’, as described in paragraph B5.4.5 of IFRS 9, because the replacement would occur as a result of a wide reform of interest rate benchmark. In addition, it would not be considered as a periodic re-estimation of cash flows, because ‘periodic’ would imply occurrence at regular intervals, which is not the case with the reform. Therefore, an entity would not apply paragraph B5.4.5 of IFRS 9 to account for the replacement of IBOR with an alternative benchmark interest rate. Instead, an entity would be required to apply paragraph 5.4.3 of IFRS 9, which specifically apply to modifications that do not result in derecognition.

### *Does the accounting outcome meet the objectives?*

32. As discussed in paragraph 31 of this paper, under the current requirements in IFRS 9, accounting for the replacement of IBOR with an alternative benchmark would require an entity to recalculate the carrying amount of the financial instrument with any modification gain or loss recognised in profit or loss. In addition, the original EIR (ie IBOR) should be used to recognise interest revenue or interest expense over the life of the financial instrument.

33. However, it is questionable whether such an outcome will provide useful information to users of financial statements. For example, assuming a financial instrument has been amended to reflect an alternative benchmark, using an IBOR-based EIR to calculate interest revenue or interest expense would not reflect the economics of the amended financial instrument. Also, maintaining the original EIR may not be practically possible for entities if the original interest rate benchmark is no longer available.

34. Finally, when IBOR is reformed or replaced on an economically equivalent basis, applying either paragraph B5.4.5 of IFRS 9 (revising the effective interest rate at the same time as cash flows are re-estimated) or paragraph B5.4.3 of IFRS 9 (recognising a modification gain or loss) would result in similar accounting outcomes, as it is unlikely that the modification gain or loss would be significant. Therefore, it could be argued that accounting for the replacement of the interest

rate benchmark as an adjustment to the EIR would significantly reduce the operational burden on preparers as they would not have to calculate the modification gain or loss on an individual instrument basis while at the same time result in no information loss to users of financial statements.

*Staff view*

35. The staff acknowledge that, as the alternative benchmarks are nearly risk-free rates, it is likely that a fixed spread (that is distinct from the credit spread on the financial instrument) will be added to the alternative benchmark rate so that the replacement occurs on an economically equivalent basis.[6] For example, when an IBOR-based financial instrument is modified to refer to an alternative benchmark rate, a fixed spread would be added to compensate for any difference between the alternative and original benchmark rates and prevent any significant transfer of economic value from one party to another. In this context, it would be unlikely that the reform or replacement of IBOR with an alternative benchmark (without any other modifications to the contractual cash flows or terms) would result in modification that is either qualitatively or quantitatively considered a substantial modification.

36. The staff is therefore of the view that applying paragraph B5.4.5 of IFRS 9 to modifications related to the reform (ie treating the modification as a 'movement in the market rates of interest') would provide more useful information to users of financial statements as it would better reflect the economics of a floating-rate financial instrument transitioning to an alternative benchmark on an economically equivalent basis. Such an approach will also significantly reduce the operational burden on preparers as they would account for the change as an update to the EIR in the same way as they are currently doing.

37. The staff therefore recommend that a practical expedient should be included in IFRS 9 so that entities apply paragraph B5.4.5 of IFRS 9 to account for contract modifications related to the reform. The staff acknowledge that it will be

[6] Based on our research activities, a spread would be added to an alternative benchmark based on the assumption that the alternative benchmark would have less credit risk than IBOR. To illustrate, assuming an IBOR-based financial instrument is issued with a spread, that spread is expected to be lower than the spread over the alternative benchmark, because the credit risk in IBOR would be greater than the credit risk in the alternative benchmark (which is a nearly risk-free rate).

important to clearly define the modifications that are related to the reform so that the practical expedient is applied only to those modifications and that the requirements in IFRS 9 are not side-stepped for other modifications.

38. With regards to the modifications related to the reform, the staff acknowledge that modifications can vary significantly across jurisdictions, product types and agreements. Developing a comprehensive list of possible modifications that might arise as a result of the reform will not be practical or possible within the timeframe of this project. Nonetheless, the staff view is that including some examples of modifications that would be considered to relate to the reform and those that would not be, will assist preparers in applying the proposed practical expedient while ensuring discipline is maintained and that there is no loss of useful information to users of financial statements.

39. Modifications related to the reform are those that will result in changes to the interest rate benchmark on which a financial instrument's contractual cash flows are based, on an economically equivalent basis, and would include:

    (a) changes to the existing benchmark rate (for example, a change from IBOR to its alternative benchmark);

    (b) changes to the fixed spread to reflect the basis difference between an existing benchmark rate and its alternative benchmark;

    (c) changes to the calculation methodology of an existing interest rate benchmark (for example, when the calculation methodology of a term rate is altered so that it becomes based on an overnight benchmark rate);

    (d) changes to the reset period, reset dates, the number of days between two coupon payments and payment dates, provided any of these changes affect the SPPI assessment; and

    (e) insertion of a fallback provision adding any of the events in items (a) to (d) above.

40. In addition to the modifications described in paragraph39, entities could also use the opportunity to modify other terms in the contract which are not related to the reform or replacement of the interest benchmark rate. For example, this would be the case if modifications relate to:

(a) changes to the financial instrument's notional amount or maturity date;

(b) changes to the counterparty credit spread;

(c) changes to the loan structure (for example, changing a term loan to a revolver loan);

(d) inclusion of an interest rate cap or floor;

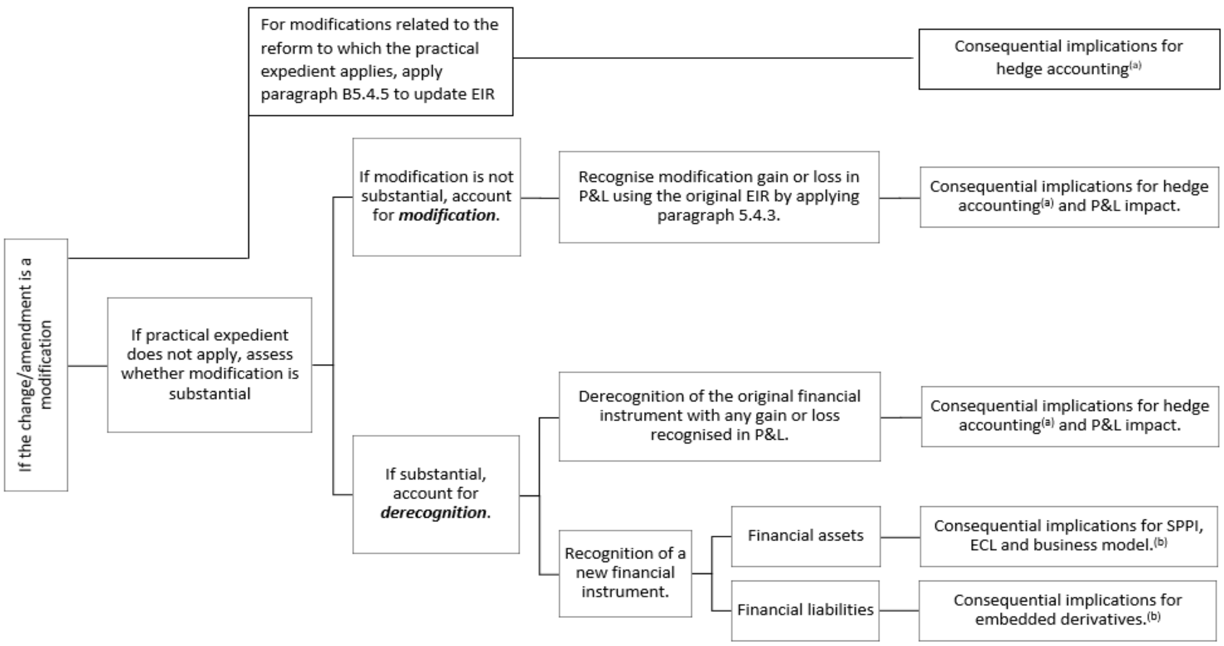
(e) the addition or removal of a prepayment or conversion option;

(f) the addition or removal of a leverage feature;

(g) changes to include an underlying reference rate that is unrelated to the interest rate benchmark, such as payments that are indexed to the price of a commodity.

41. Any modifications that not related to the reform would not qualify to be accounted for in accordance with the practical expedient and, therefore, should be assessed in accordance with the current requirements in IFRS 9 to determine whether the modification is substantial.

42. The following flowchart summarises the possible accounting outcomes after assessing whether the practical expedient applies for a particular modification of a financial instrument.



## Order in which modifications should be accounted for

43. As noted earlier in this paper, IFRS 9 already includes guidance on how to account for modifications of contractual terms or cash flows. When modifications, other than those related to the reform, are made an entity should apply the requirements in paragraph 5.4.3 of IFRS 9 to those changes (assuming that the changes are not substantial and do not result in derecognition). That is, the gross carrying amount of the financial instrument should be recalculated as the present value of the modified contractual cash flows discounted at the original EIR and any modification gain or loss recognised in profit or loss.

44. However, the question that arises is regarding the order in which an entity should account for the different types of modifications that are not deemed to be substantial. For example, if modifications that are not related to the reform are first accounted for, then in applying paragraph 5.4.3 of IFRS 9 the carrying amount of the financial instrument will be based on the original IBOR-based EIR and, therefore, it will not amortise to zero at maturity (ie will not 'pull to par') as the subsequent present value calculations will be done using an EIR based on the alternative benchmark rate.

*Staff view*

45. Assuming the Board agrees with the staff recommendation in paragraphs 38-41, the staff further recommend that IFRS 9 should be amended to clarify that an entity should first apply the practical expedient, that is, to account for the modifications related to the reform (ie changes related to the interest rate benchmark on which a financial instrument's contractual cash flows are based) by updating the EIR based on the alternative benchmark without adjustments to the carrying amount. Thereafter, an entity should apply the current IFRS 9 requirements to determine if any other modifications to that financial instrument are substantial and, if those modifications are not substantial, the entity should use the updated EIR to recalculate the carrying amount of that financial instrument with any modification gain or loss recognised in profit or loss in accordance with

paragraph 5.4.3 of IFRS 9[7]. Such an approach would provide useful information to users of financial statements about the economic effects of any other modifications to financial instruments.

46. The staff think that adding an illustrative example to IFRS 9 to demonstrate the current principles and the order of accounting described in paragraph 45 would be useful to ensure consistent application of IFRS 9 modification guidance.

## Questions for the Board

**Questions for the Board**

1) Does the Board have any questions or comments on the individual sections of the paper that discuss:
   (a) what a modification is;
   (b) how to determine whether a modification is substantial;
   (c) the practical expedient for modifications that are related to the reform; and
   (d) the order in which modifications should be accounted for?

2) Does the Board agree with the staff recommendations set out in paragraph 4?

[7] Modifications that are deemed to be substantial are discussed in Agenda Paper 14B *Accounting implications from the derecognition of a modified financial instrument*.