IFRS® Accounting

Staff paper

Agenda reference: 2

Accounting Standards Advisory Forum meeting

Date **December 2025**

Project **Amortised Cost Measurement**

Topic **Deliberations of project topics**

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Introduction

- The IASB started the Amortised Cost Measurement project in response to feedback on its post-implementation reviews of IFRS 9 *Financial Instruments*.
- The project aims to make targeted improvements to IFRS 9, addressing application issues that are widespread and have a material effect on entities' financial statements.
- From September 2025, the IASB has started to deliberate potential solutions to application issues in scope of this project.
- After considering the input from its consultative groups, the IASB plans to make decisions about the proposed solutions during H1 2026.

Purpose of this meeting

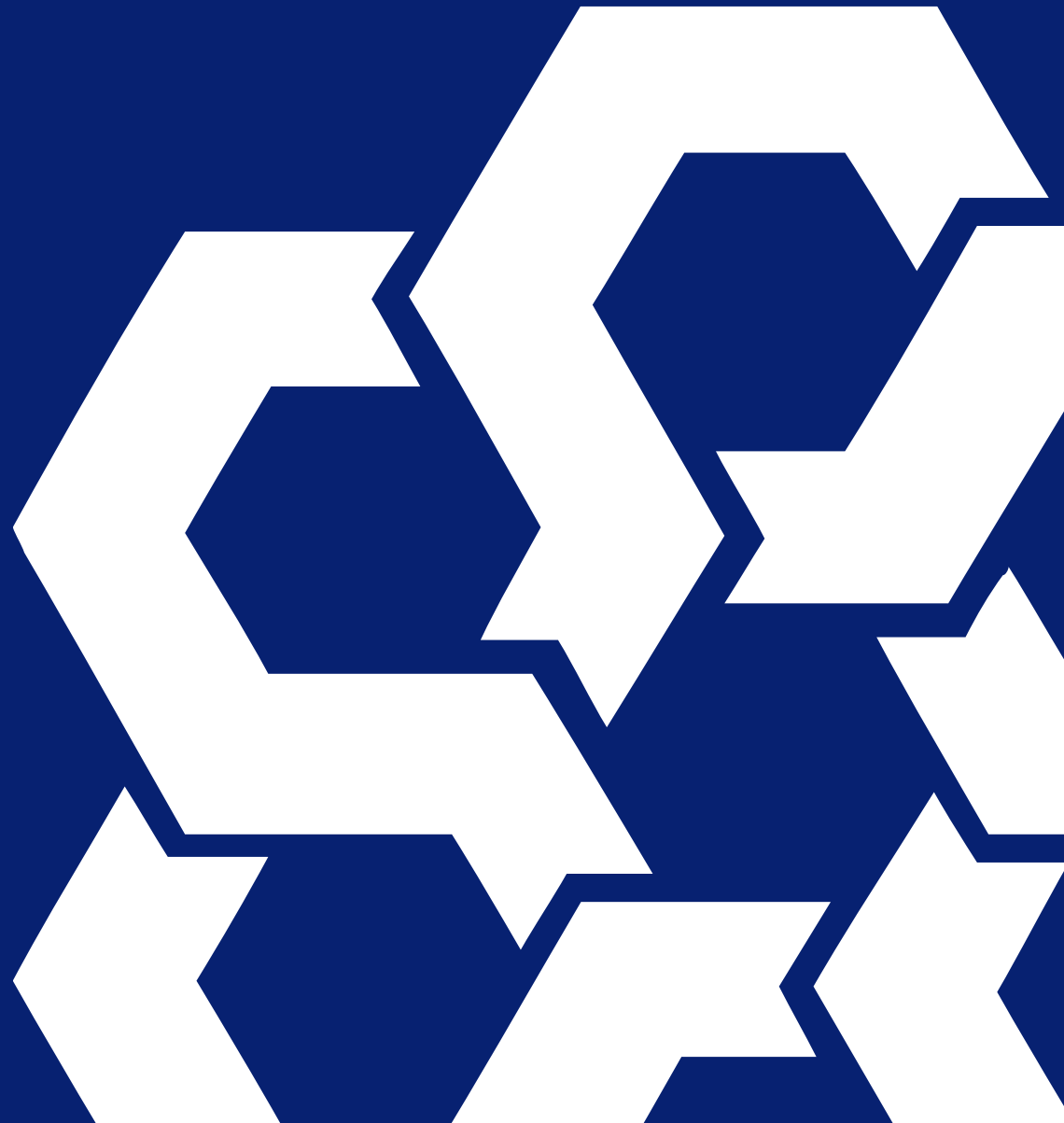
The purpose of this meeting is to obtain your input on the following topics:

1. **Changes in Effective Interest Rate (EIR)**. Specifically, which changes in expected cash flows are accounted for applying paragraph B5.4.5 versus paragraph B5.4.6 of IFRS 9. The topic is most relevant to financial assets and liabilities with conditions attached to the contractual interest rate, such as credit ratchet, stepped interest or ESG-linked features.

2. **Modifications of financial instruments**. Specifically, how to assess whether a modification of a financial asset or financial liability is substantial, resulting in derecognition. The topic is relevant to all modified financial assets or liabilities.

Contents

Questions for ASAF members



Questions for ASAF members

1. **Changes in EIR for financial assets and liabilities**

   (slides 11–18)

On the accounting for changes in EIR:

a. Do you have any suggestions about alternatives for clarifying IFRS 9 requirements on resetting the EIR, applying paragraph B5.4.5 of IFRS 9?
   See slides 16–17 for the IASB's preliminary discussion.

b. As amortised cost is a cost-based measure, not a current or fair value-based measure, in which circumstances do you think recognising a catch-up adjustment (paragraph B5.4.6 of IFRS 9) provide more useful information relative to resetting the EIR (paragraph B5.4.5 of IFRS 9)?
   See slide 18 for an illustrative example.

Please specify the rationale for your view.

Questions for ASAF members

2. Modification of financial assets and liabilities

(slides 19–23)

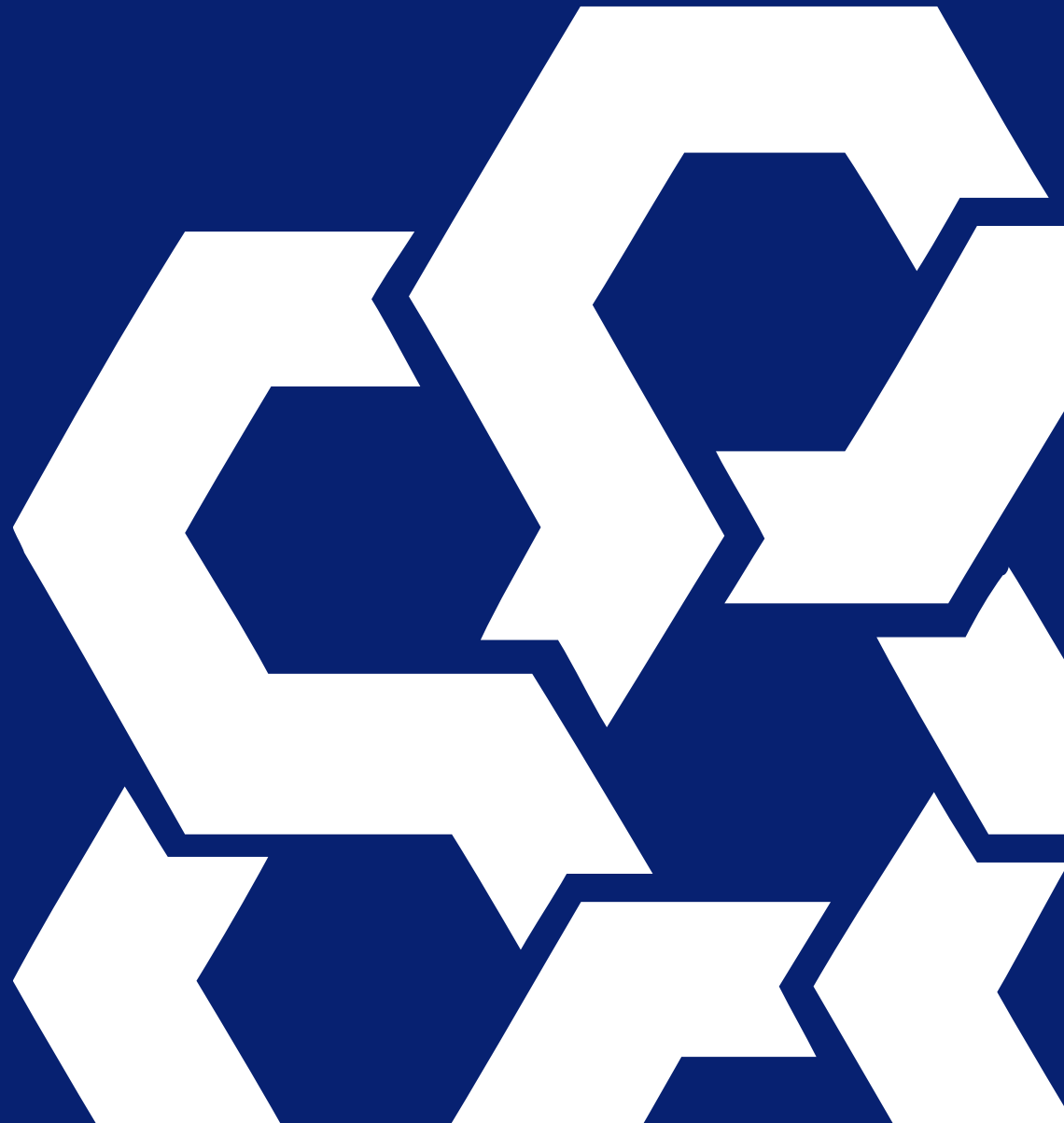
On the accounting for modification of financial instruments:

a. What is your view on the staff approach to potential improvements for requirements on modification of financial assets and financial liabilities, as described in slide 23?

b. Do you think the reason for modification of a financial asset (for example, credit risk deterioration versus commercial renegotiation) is an important factor to consider in assessing whether modification of a financial asset results in derecognition? If so, how do you think considering this factor interacts with the requirements on expected credit losses?

Please specify the rationale for your view.

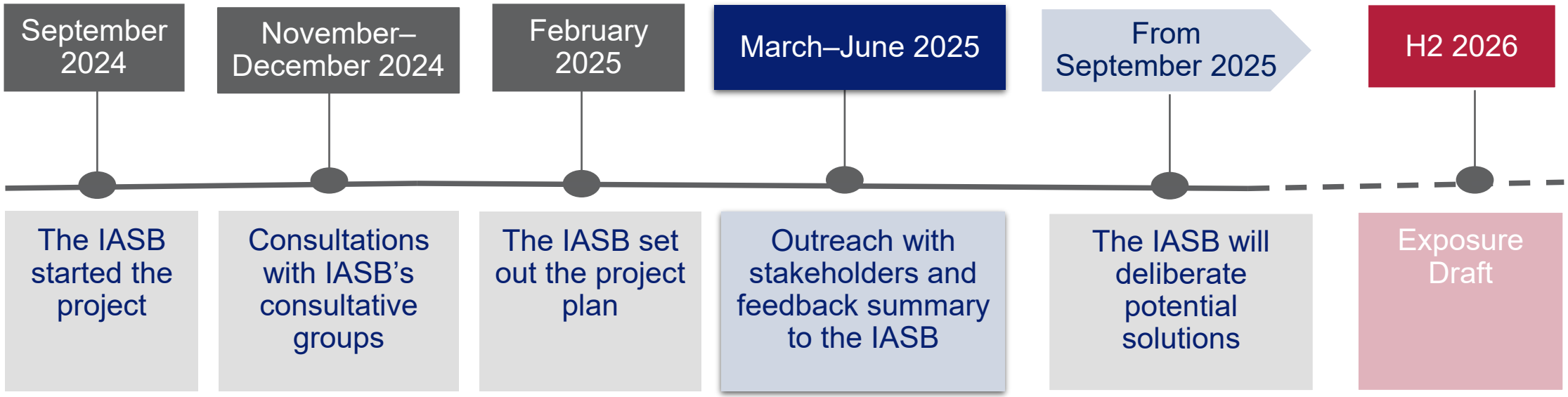
Project Overview



Objectives and timeline

Objectives

- to **clarify principles** underlying the amortised cost measurement requirements in IFRS 9, addressing application issues that are widespread and have a material effect on entities' financial statements; and
- to **improve specific information** provided to **users** of financial statements about financial instruments measured at amortised cost



Project plan

Key topics for IASB discussion

Determining EIR

How to calculate the effective interest rate (EIR) for financial instruments with conditions linked to interest rates?

Discussion: From September 2025
Outcome: No standard-setting

Changes in EIR

Which changes in expected cash flows are accounted for applying paragraph B5.4.5 versus B5.4.6 of IFRS 9?

Discussion: From September 2025
Outcome: To continue deliberations

Modification of financial instruments

How to assess if a modification is substantial, resulting in derecognition of a financial asset or a financial liability?

Discussion: Q4 2025
Outcome: TBD

Modification, derecognition and impairment

How to distinguish between modification versus derecognition versus impairment?

Discussion: Q4 2025

Outcome: TBD

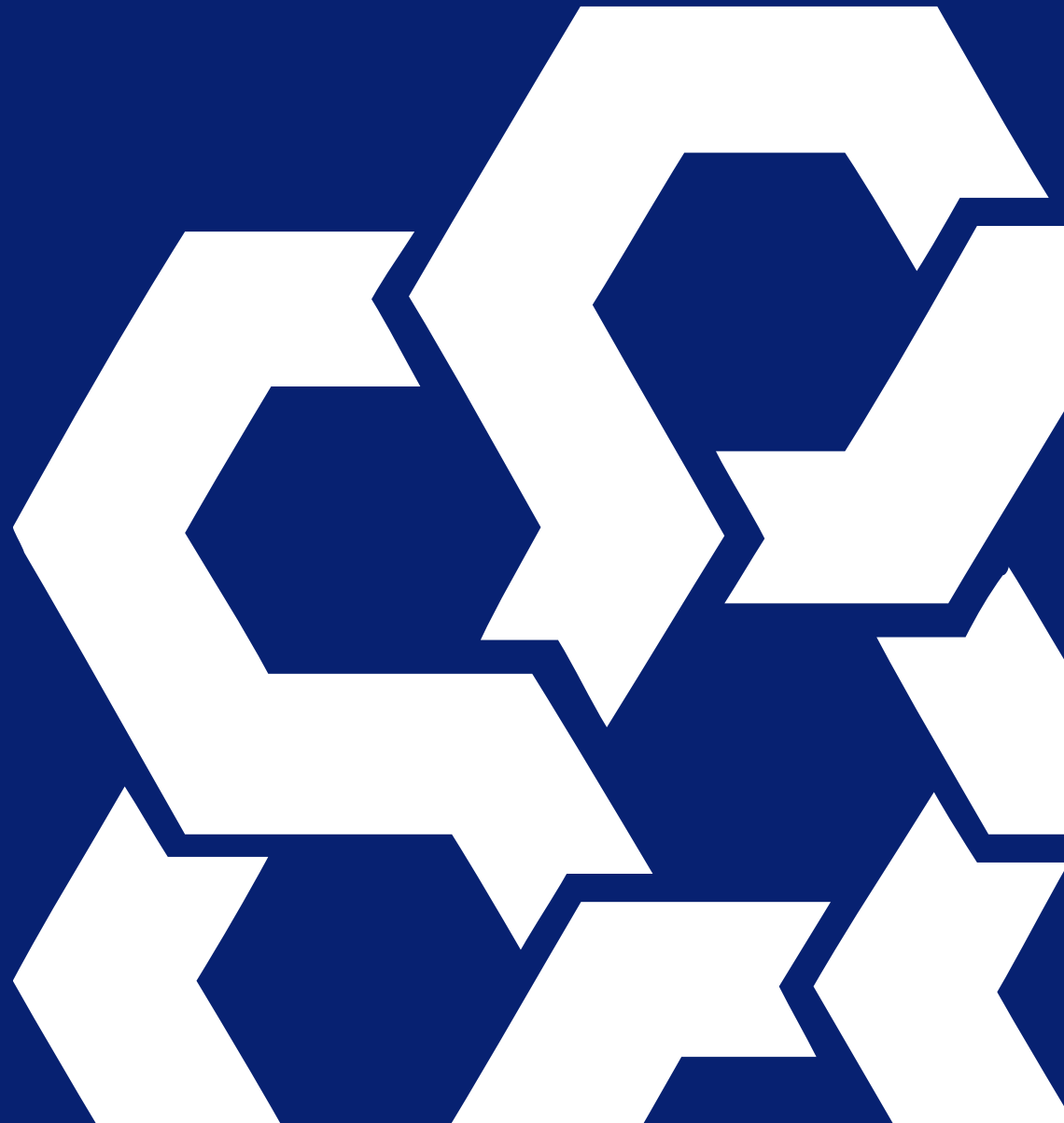
Other matters

What about other matters that need clarification, such as accounting for transaction costs and fees?

Discussion: Q1 / Q2 2026

Outcome: TBD

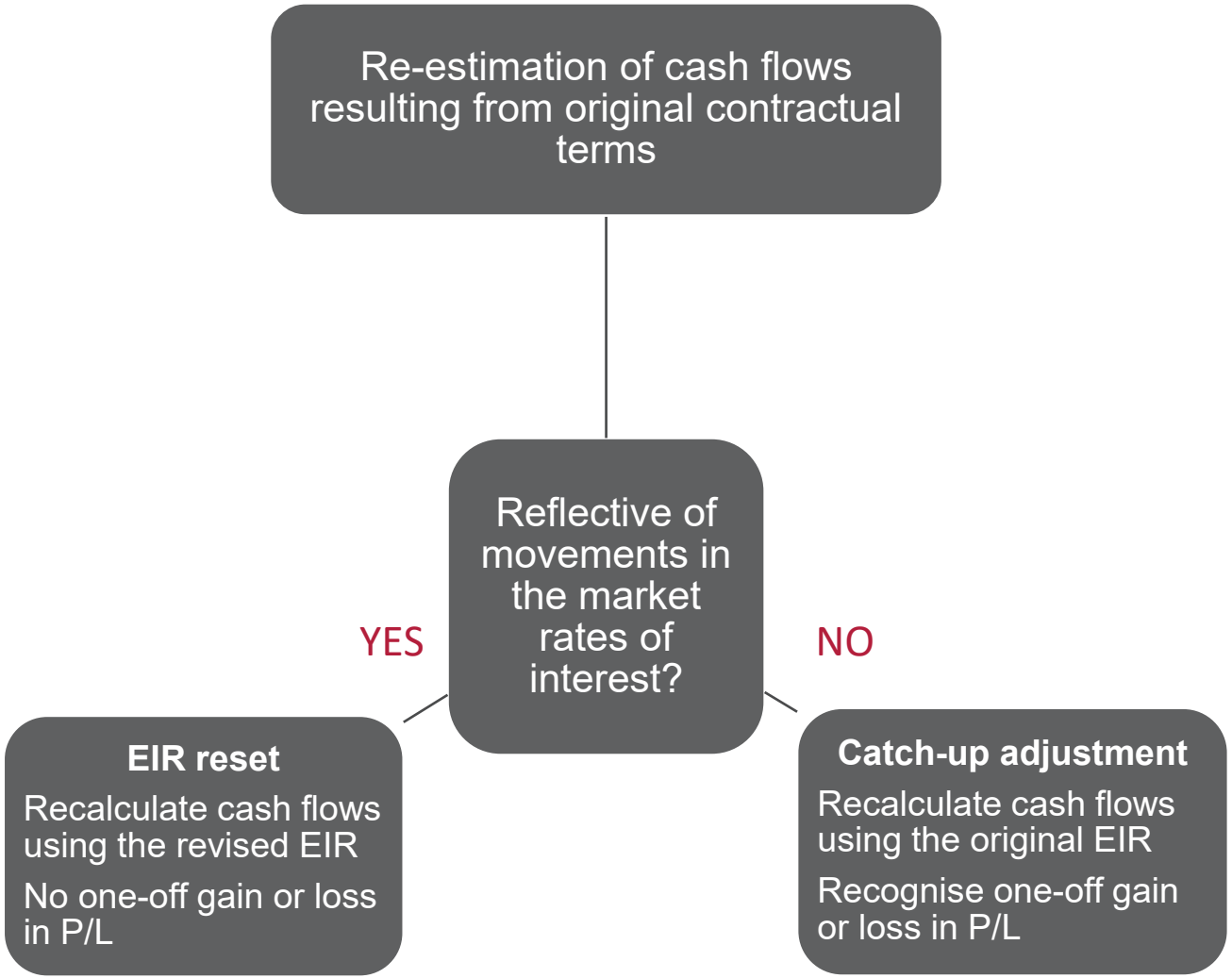
Changes in EIR



IFRS 9 requirements

Paragraph B5.4.5 and B5.4.6 of IFRS 9 set out requirements on accounting of changes in expected cash flows:

- paragraph B5.4.5 states that, for floating-rate financial instruments, periodic re-estimation of cash flows to reflect the movements in the **market rates of interest** alters the EIR. That is, re-estimation of cash flows under the revised EIR without causing a one-time gain or loss in profit or loss (**EIR reset**).
- paragraph B5.4.6 requires that, for revisions of expected cash flows, the entity recalculates the gross carrying amount of the financial asset or amortised cost of the financial liability as the present value of the estimated future contractual cash flows that are discounted at the financial instrument's **original EIR**. That is, re-estimation of cash flows under the original EIR, causing a one-time gain or loss in profit or loss (**catch-up adjustment**).



Requests for clarification

- The IASB has been repeatedly asked to clarify the requirements for accounting of changes in expected cash flows. Specifically:
  - how is an entity required to account for subsequent changes in estimated interest cash flows—by applying paragraph B5.4.5 or applying paragraph B5.4.6 of IFRS 9?
  - what is the meaning of a ‘floating rate’ financial instrument in paragraph B5.4.5 of IFRS 9 and whether it refers to the overall contractual rate or a component thereof?
  - what is the meaning of ‘movements in market rates of interest’ in paragraph B5.4.5 of IFRS 9 and whether this includes any adjustments to the contractual interest rate?

- The IASB acknowledges that the requirements in paragraphs B5.4.5–B5.4.6 of IFRS 9 are not sufficiently clear. Furthermore, it is not clear what each set of requirements is designed to achieve or information aimed to provide.
- The diversity in practice is generally attributable to unclear requirements. So, the IASB needs to explore potential solutions.

Financial instruments subject to application issues

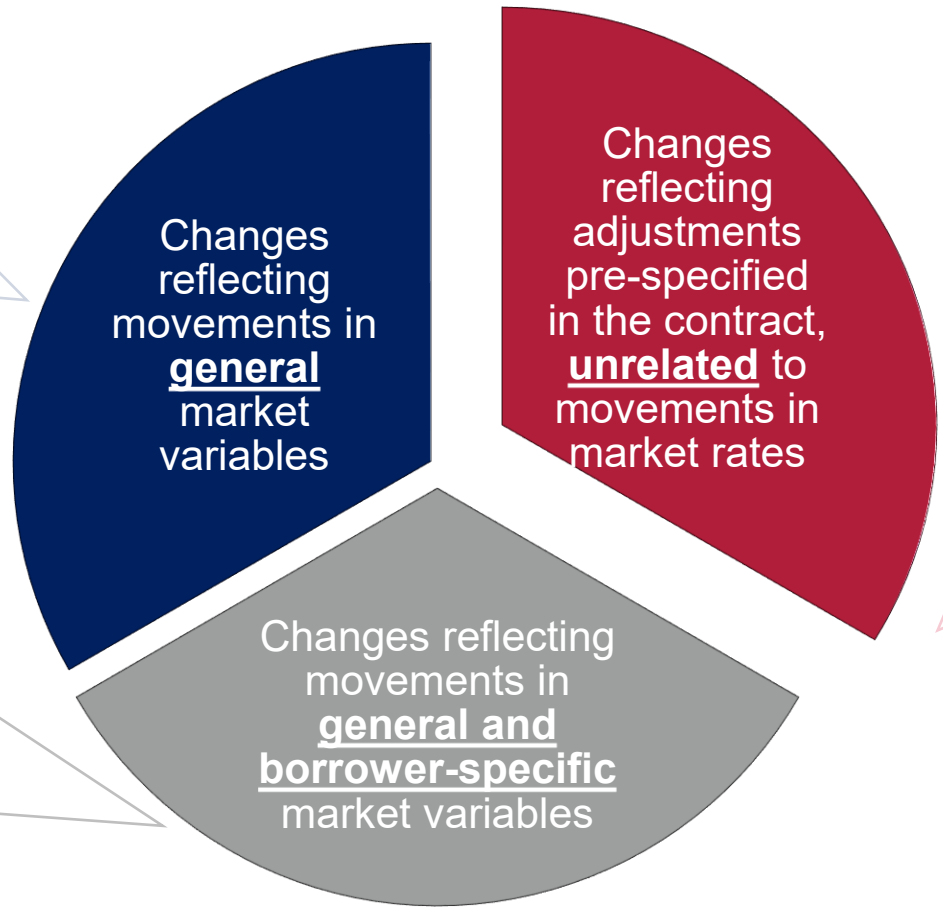
Over the years, stakeholders requested clarifications on application of paragraphs B5.4.5–B5.4.6 with reference to different contractual terms and conditions, such as:

- **credit ratchet features**. For example, a loan with a credit spread that is adjusted based on a predetermined rate scale (ratcheted) upon the occurrence of specified events related to the borrower's credit risk.
- **stepped interest features.** For example, a predetermined rate of interest on the principal amount that increases progressively over the life of the instrument.
- **ESG-linked features**. For example, a predetermined change in the contractual interest rate that is contingent on the borrower meeting specific ESG targets.
- **TLTRO III transactions**. The third programme of the targeted longer-term refinancing operations (TLTROs) of the European Central Bank (ECB). The TLTROs link the amount a participating bank can borrow and the interest rate the bank pays on each tranche of the operation to the volume and amount of loans it makes to non-financial corporations and households.

Why there is diversity in practice?

Changes in the contractual interest rates

- A few companies apply paragraph B5.4.5 **only** to these changes
- For example, movements in benchmark interest rates (eg SONIA)



- Some companies apply it to all changes (including credit spread), if they represent movements in market rates of interest
- For example, reset the EIR for changes aligned to movements in market rate for similar instruments, with similar credit rating

- Many companies apply B5.4.5 even to changes in interest cash flows which do not represent movements in market rates of interest
- For example, pre-specified adjustments to a contractual interest rate inconsistent with prevailing market rate

Potential alternatives to clarifying paragraph B5.4.5

This illustration summarises three alternatives the IASB preliminarily discussed in September 2025

AMORTISED COST

Alternative A
Apply paragraph B5.4.5 (that is, EIR reset) only to changes in interest rate components that reflect movements in general market-based variables.
For example:
- benchmark interest rate
- inflation rate

For all other changes, apply paragraph B5.4.6 of IFRS 9.

Alternative B
EIR reset for all interest rate components that reflect movements in market rates of interest. That is, movements in both general market-based and borrower-specific variables (such as credit spread).

For example:
- benchmark interest rate
- inflation rate
- credit spread

FAIR VALUE

OTHER BASIS

Alternative C
EIR reset for all movements in the contractual interest rate that reflect any changes specified in the contract, including non-market changes.
This might update the EIR for any contractually specified variable, including:
- benchmark interest rate
- inflation rate
- credit spread
- pre-determined adjustments, even if they cause the contractual interest rate to move independently of market rates prevailing at the time the contingent event occurs

IASB deliberations of potential alternatives

- The IASB considered that:
  - alternatives A–C discussed in September 2025 represent three distinct approaches, each at opposite ends of a broad spectrum;
  - none of these alternatives, at its current form, achieve an optimal balance between costs and benefits
  - there may be other possible alternatives, combining elements of alternatives A–C, that better balance costs and benefits;
  - to explore those additional alternatives, the IASB will seek input from its consultative groups.
- Agenda Paper 11B of the IASB's September 2025 meeting discusses these alternatives in detail, including advantages, disadvantages and potential impact to current practice

- The IASB is seeking input from stakeholders to inform its decision on this topic:
  - input from investors will help the IASB to determine what information is decision useful for investors
  - input from the IASB's consultative groups will help the IASB identify other alternatives that might better balance costs and benefits

Illustrative Example

Bank ABC issues a 10-year loan of CU1 million with contractual interest rate of 4%. The contract specifies that the contractual interest rate will increase by 1% following an increase in risk of default occurring compared to risk at initial recognition.

For purpose of this example, assume the EIR at initial recognition is determined to be 4% (no fees or costs).

In Year 5 the risk of a default occurring on the loan increases, triggering a 1% increase of the contractual interest rate. The contractual interest rate is now 5%. The market rate of interest for a similar instrument with a similar credit rating is 6%.

Under this scenario, what accounting outcome you think would provide more useful information:

- EIR reset, applying paragraph B5.4.5 of IFRS 9. Proponents of this view argue that adjusting the EIR to 5%, more faithfully represents the economics as it would align with the **over time** increase in contractual cash flows. However, they acknowledge that the change does not represent movements in market rates of interest, required by B5.4.5.

- Catch-up adjustment, applying paragraph B5.4.6 of IFRS 9. Proponents of this view note that this increase was not expected when entering into the contract, as evidenced by the fact that Bank ABC set the EIR at 4% at initial recognition, instead of using a blended rate to provide for the possibility of the contractual interest rate increasing in the future.
- So, keeping the EIR at 4% and recognising a ***one-off*** gain better represents such an unexpected change in contractual cash flows.
- They note that keeping the original EIR is also more consistent with amortised cost, which is a cost-based measure. Continuously revising the EIR of an instrument results in an approach that is akin to cash accounting.

Modification of financial instruments

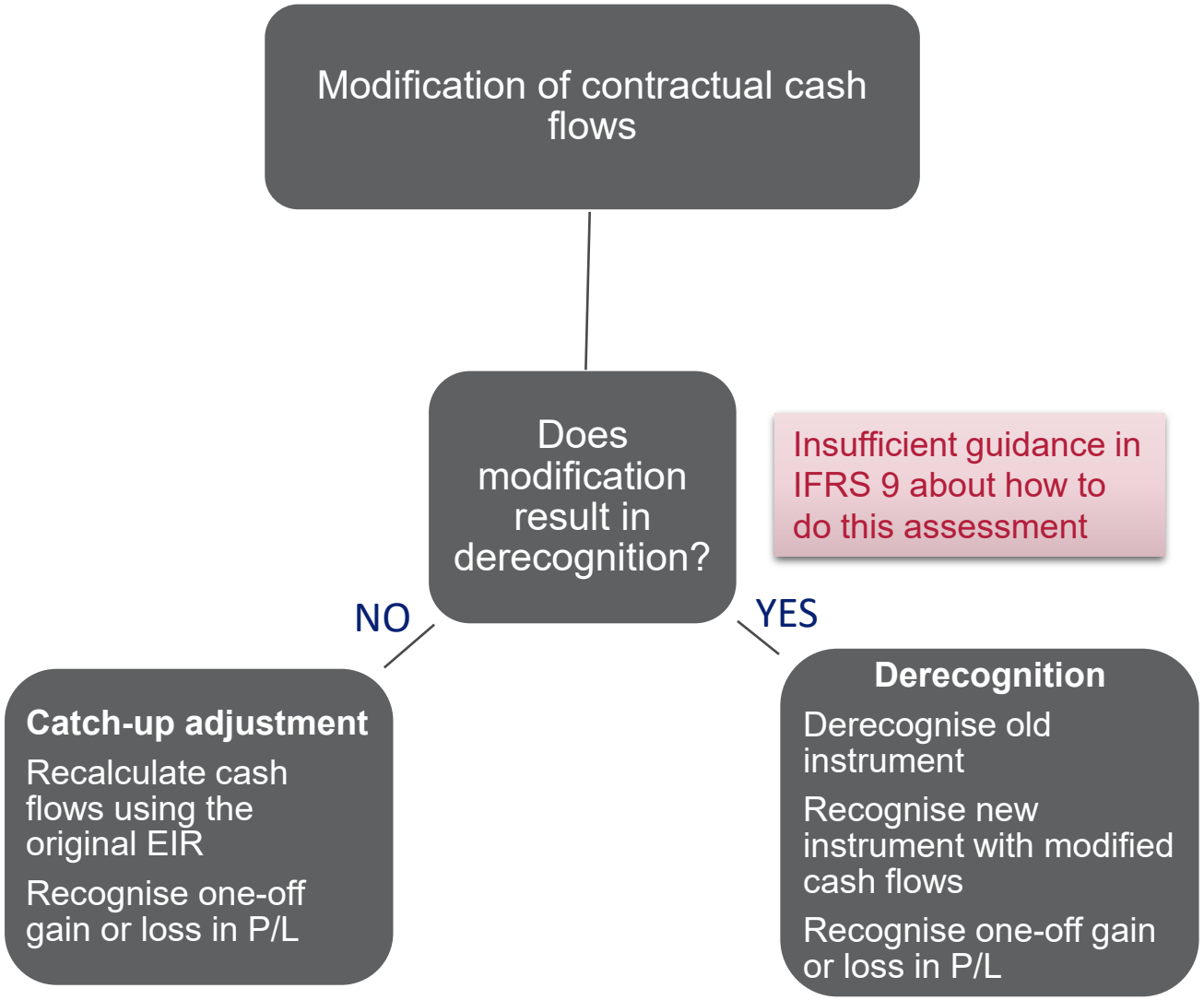
IFRS 9 requirements

Financial liabilities

- Paragraph B3.3.6 of IFRS 9 provides application guidance about assessing whether a modification is substantial, resulting in derecognition of a financial liability.
- The guidance sets out a quantitative test—**'ten per cent test'** (that is, if the discounted present value of the cash flows under the new terms is at least ten per cent different from the discounted present value of the remaining cash flows of the original financial liability)

Financial assets

- Paragraph 3.2.3 of IFRS 9 focusses on an assessment of contractual cash flows and provides specific requirements when an entity derecognises a financial asset.
- Paragraph 5.4.3 of IFRS 9 sets out requirements for modification of financial assets that do not result in derecognition.
- IFRS 9 has no specific guidance for assessing whether a modification results in a derecognition of an asset.



Requests for clarification

- Stakeholders have told the IASB that assessing whether a modification of a financial instrument is ‘substantial’ and thus results in derecognition of that instrument is one of the areas with greatest diversity in practice.
- Most respondents to the PIRs of IFRS 9 asked the IASB to clarify requirements and provide application guidance about this assessment. They further asked:
  - for financial liabilities—whether the assessment of a modification as ‘substantial’ is purely e based on the quantitative ten per cent test (as described in paragraph B3.3.6 of IFRS 9) or an entity can conclude on the assessment based on qualitative factors, even if the ten per cent test is not met.
  - for financial assets—how to assess if a modification results in derecognition given IFRS 9 has no guidance.
  - how to do the modification assessment for revolving credit facilities, such as credit cards and overdrafts.

- The IASB acknowledged that IFRS 9 does not provide sufficient application guidance about this assessment, in particular for financial assets
- Given the significant diversity in practice and that the guidance is asymmetrical between financial assets and financial liabilities, the IASB will need to explore potential improvements to IFRS 9

Why there is diversity in practice?

Financial liabilities

- Some entities first do the ten per cent test (specified in paragraph B3.3.6 of IFRS 9) and, if that test is not met, then they also do a qualitative assessment (for example, assessing if terms such as maturity or currency have been changed). Others rely solely on the ten per cent test, without any further qualitative assessment.

Financial assets

- Some entities perform only qualitative tests (for example, by considering whether a modification results in a financial asset no longer having cash flows that are solely payments of principal and interest), whereas a few others apply the ten per cent test in addition to the qualitative test.
- Remaining entities, specifically some financial institutions, determine the accounting outcomes based on the staging of the modified financial asset for expected credit losses (ECL) and the reason behind its modification:
  - if a modified financial asset is classified in stage 1 (performing) for ECL purposes, they would deem it as **substantial** modification and derecognise the asset…
  - if a modified financial asset is classified in stage 2 (underperforming) or stage 3 (credit-impaired), they would deem it as a **non-substantial modification** and either account for it applying paragraph B5.4.6 of IFRS 9 or not account for such a modification at all because, in their view, the effect of such modification would have already been captured through ECL…

Staff approach to potential improvements

- In exploring potential solutions, the IASB would need to consider, to what extent the application guidance should be aligned between financial assets and financial liabilities.
- To the extent that differences in requirements or terminology are justified, potential clarifications should also include the basis for such conclusions to avoid any unintended consequences.
- The staff preliminary view is that the IASB could consider:
  - a principles-based approach to assessing whether a modification is substantial and results in derecognition. For example, a factors-based approach, providing a list of non-exhaustive factors an entity would be required to consider in determining whether modification of a financial instrument results in derecognition.
  - to the extent possible, the assessment approach to be symmetrical between financial assets and financial liabilities. However, factors exclusive to financial assets such as ‘solely payments of principal and interest’ and the expected credit losses might also need to be considered.
  - specifying that the ten per cent test not be the **only** or the **determining** factor in assessing whether a modification results in derecognition.
  - aim to provide guidance about how entities perform modification assessment for revolving credit facilities, such as credit cards and overdrafts (these instruments might not have a fixed term or repayment structure).

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