Staff paper

Agenda reference: 11B

IASB® meeting

Date	**September 2025**
Project	**Amortised Cost Measurement**
Topic	**Subsequent changes to the effective interest rate**

Contacts: Iliriana Feka (ifeka@ifrs.org), Riana Wiesner (rwiesner@ifrs.org), Yue Rong (yue.rong@ifrs.org)

Purpose and structure of the paper

1. At this meeting, the IASB begins the deliberations of issues in scope of the Amortised Cost Measurement project.

2. This paper sets out the preliminary staff analysis on whether the IASB should clarify the accounting for subsequent changes to the effective interest rate (EIR) and outlines potential alternatives. We do not ask the IASB to make any decisions in this paper but invite questions or comments on the staff analysis.

3. This paper is structured as follows:

   (a) summary of staff preliminary views;

   (b) questions for the IASB;

   (c) background;

   (d) a reminder of the 2025 outreach feedback; and

   (e) staff preliminary analysis and views.

4. The paper includes two appendices: Appendix A— Illustration of potential alternatives and Appendix B—Review of accounting firms' manuals.

Summary of staff preliminary views

5. We think the IASB should consider clarifying the requirements related to accounting for subsequent changes to the EIR, as diversity in application stems from unclear requirements or insufficient application guidance in IFRS 9 *Financial Instruments*.

6. At this preliminary stage of deliberations, the alternatives discussed in this paper represent three distinct approaches, each at opposite ends of a broad spectrum, to clarifying paragraph B5.4.5 of IFRS 9. These alternatives were identified based on current practices noted in outreach with stakeholders and our analysis of IFRS 9 requirements.

7. There may be other possible alternatives, combining elements of the alternatives discussed in this paper, that better balance costs and benefits. However, to explore those additional alternatives we would ask for some direction from the IASB, as outlined in paragraph 73.

8. We also plan to discuss this topic with the IASB's consultative groups in Q4 2025. The IASB might then be asked to make decisions on this topic in Q1 2026.

Questions for the IASB

Questions for the IASB
Does the IASB have any comments or questions on the preliminary staff analysis in this paper? Specifically: a) do you think there are any variations to alternatives A–C that could more effectively balance costs and benefits? b) are there any other alternatives you would like the staff to explore? Similarly, are there any of the alternatives presented in this paper that you think should be excluded from further consideration? c) are there any points you would like the staff to research further or to highlight for consultation with the IASB's consultative groups?

Background

IFRS 9 requirements

Paragraph B5.4.5 of IFRS 9 applies to floating-rate financial instruments, stating:

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.

Paragraph B5.4.6 of IFRS 9 applies to changes in estimated future cash flows of a financial instrument other than those addressed in paragraph B5.4.5 of IFRS 9, stating:

If an entity revises its estimates of payments or receipts (excluding modifications in accordance with paragraph 5.4.3 and changes in estimates of expected credit losses), it shall adjust the gross carrying amount of the financial asset or amortised cost of a financial liability (or group of financial instruments) to reflect actual and revised estimated contractual cash flows. … The adjustment is recognised in profit or loss as income or expense.

Feedback on the post-implementation reviews (PIRs) of IFRS 9

Many respondents to the PIRs of IFRS 9 reiterated the long-standing request for clarifications on what subsequent changes in estimated cash flows are accounted for by adjusting the EIR (applying paragraph B5.4.5 of IFRS 9) or through a cumulative catch-up adjustment (applying paragraph B5.4.6 of IFRS 9).

They further asked for clarification on the meaning of terms used in paragraph B5.4.5:

- a '**floating-rate**' financial instrument—whether this refers to the entire contractual rate or only a component or element thereof; and
- '**movements in the market rates of interest**'—whether this includes any contractually specified adjustments to the contractual interest rate.

IASB's previous projects

TLTRO III transactions

The IFRS Interpretations Committee (Committee) received a request about how to account for 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.

Among other questions, the Committee was asked:

- whether the bank applies paragraph B5.4.6 of IFRS 9 to account for changes in estimated cash flows resulting from the revised assessment of whether the conditions attached to the liability have been met; and
- how the bank accounts for changes in cash flows related to the prior period that result from the bank's lending behaviour or from changes the ECB makes to the TLTRO III conditions.

The Committee concluded that the matters noted in the request were not possible to address in a cost-effective manner and were reported to the IASB.

2009 Exposure Draft

In November 2009, the IASB published the Exposure Draft *Financial Instruments: Amortised Cost and Impairment* (2009 Exposure Draft) as part of replacing IAS 39 *Financial Instruments: Recognition and Measurement.* This Exposure Draft included amortised cost measurement principles that would apply to both fixed rate and variable rate instruments.

In developing the proposals of the 2009 Exposure Draft, the IASB deliberated extensively the EIR mechanics in context of variable rate financial instruments.

The application guidance in the 2009 Exposure Draft generally provided guidance about using 'catch-up' adjustment mechanism for variable rate instruments. However, paragraph B12 of the 2009 Exposure Draft specified that for a floating rate financial instrument that resets a benchmark interest component (eg LIBOR plus 100 basis points), periodic re-estimation of cash flows to reflect **changes in the benchmark interest rate** would alter the EIR in relation to that benchmark component. This meant that the spot curve for the benchmark interest rate would be updated while the initial effective spread would remain constant. Hence, each cash flow of the floating rate financial instrument would be discounted using a rate that is the combination of the applicable spot rate for each cash flow date; plus the initial effective spread.

In response to the 2009 Exposure Draft, many stakeholders said that the application of the principles to variable rate instruments cannot be readily understood, in particular the process for re-evaluating the EIR on such instruments.
The proposed EIR mechanics were viewed as conceptually pure but practically overwhelming. Many suggested the IASB provide a simplified approach for variable rate instruments.

As a result, the IASB did not proceed with the 2009 Exposure Draft proposals, carrying forward the effective interest method requirements from IAS 39 in IFRS 9, without substantive changes.

A reminder of the 2025 outreach feedback

9. In H1 2025, the IASB met with stakeholders from various industries and geographical regions (2025 outreach) to gather information about the root causes of diversity in application of the amortised cost measurement requirements in IFRS 9.

10. Paragraphs 11–18 summarise the key messages from this outreach, regarding the application of requirements for accounting of subsequent changes to the EIR. [1]

No guiding principle

11. Our questions for outreach participants on this topic aimed to determine if there is a consistent and specific rationale underlying entities' application of paragraph B5.4.5 versus paragraph B5.4.6 of IFRS 9. Our objective was to understand how entities determine whether to apply paragraph B5.4.5 or paragraph B5.4.6 of IFRS 9 to transactions.

12. Participants described varying practices and interpretations about the requirements in paragraph B5.4.5 and paragraph B5.4.6 of IFRS 9, but there was no consensus about the rationale for, or articulation of the basis for their conclusions on, the different approaches being applied.

Different accounting practices

13. A few participants said that they take a '**narrow view**' on the changes in interest rates that are reflective of 'movements in market rates of interest' and therefore, they only apply paragraph B5.4.5 to account for movements in benchmark component of an interest rate. For this purpose, changes arising from borrower-specific factors were not viewed as reflective of movements in market rates of interest. For example, the changes in interest rates due to credit ratchets where the rate is reset to reflect pre-determined changes in the credit spread of the borrower were not considered

[1] Agenda Paper 11A of the June 2025 IASB meeting provides detailed feedback from the 2025 outreach.

reflective of movements in market rates of interest. Consequently, these changes were accounted for through a catch-up adjustment applying paragraph B5.4.6 of IFRS 9, not by adjusting the EIR applying paragraph B5.4.5.

14. All other outreach participants said that they take a '**broad view**' on the changes in interest rate that they consider reflective of 'movements in the market rates of interest'. In their view, 'market rates of interest' can relate to one or more of the different components that comprise the contractual interest rate and can arise from both market-wide changes (ie general market conditions) and changes arising from borrower-specific factors. However, there were varying practices even within the participants that took a broad view.

15. Some participants linked the concept of movements in 'market rate of interest' to the changes that reset the **entire interest rate** to its **prevailing market rate**. They explained that their key assessment is whether a movement in any component of the contractual interest rate is effectively repricing the entire contractual interest rate to the prevailing market rate for that instrument on that date (ie to its fair value). If it does, paragraph B5.4.5 of IFRS 9 applies. These participants did not differentiate between the movements in market rates of interest resulting from general market conditions (such as changes in benchmark interest rate) and those arising from borrower-specific factors (such as changes in borrower's credit risk).

16. Some other outreach participants linked the concept of movements in 'market rate of interest' to **any change** in the contractual interest rate of a floating rate financial instrument. In their view, while only a component of the interest rate may be reset to its market value (such as the benchmark interest component), paragraph B5.4.5 does not apply exclusively to this floating component. Rather, the entire contractual interest rate of such an instrument is considered a 'market floating rate' and therefore any change in that contractual interest rate is accounted for by adjusting the EIR applying paragraph B5.4.5 of IFRS 9.

17. For example, the participants mentioned in paragraphs 15–16 all applied paragraph B5.4.5 of IFRS 9 even to the pre-determined changes in contractual interest rates

due to credit ratchets.[2] However, the participants in paragraph 15 acknowledged that a predetermined adjustment to the contractual interest rate cannot represent the future market rate of interest (ie an entity cannot predict the market rate of interest that would prevail at a future date). It only reflects an expectation of what the market rate of interest might be at the time the contingent event occurs.

18. A few of the participants mentioned in paragraph 16 took a 'broad view' even on the type of instruments in scope of paragraph B5.4.5 of IFRS 9, applying it to some fixed-rate instruments too. This is despite the clear reference in that paragraph to **floating-rate** instruments. For example, they viewed a **fixed-rate** loan that the borrower may prepay at any time at par, or with only negligible compensation, as similar to a 'floating-rate' loan. In their view, the prepayment feature enables the borrower to renegotiate the interest rate at any time to align with the prevailing market rate, therefore effectively making it a floating-rate loan.

Staff preliminary analysis and views

19. As noted in Agenda Paper 11A of the June 2025 IASB meeting, the 2025 outreach feedback suggests that the diversity in application of requirements in paragraphs B5.4.5 and B5.4.6 of IFRS 9 generally stems from varied interpretations of what changes in interest rates are reflective of a movement in 'market rates of interest'.

20. In our view, these interpretations arise because, among other reasons, IFRS 9:

    (a) describes the mechanics of accounting for subsequent changes in estimated cash flows in paragraphs B5.4.5 and B5.4.6 without articulating what each mechanism is designed to achieve.

    (b) uses the phrase 'market rates of interest' differently in different parts of the Standard. For instance, paragraph B5.1.1 of IFRS 9 refers to the 'prevailing

[2] An example of a financial instrument with a credit-ratchet feature is if a loan has 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.

market rate(s) of interest' used to determine the fair value of a financial instrument at initial recognition, while paragraph B5.4.5 refers to 'movements in the market rates of interest' without any further explanation of what this means or, whether or not this is similar to the concept of fair value.

21. Accordingly, we think the IASB should consider clarifying the amortised measurement principles to support greater consistency in application.

22. To facilitate the IASB's discussion of potential clarifications, next sections provide:

(a) a reminder of the basis for amortised cost and the effective interest method;

(b) an analysis of the EIR mechanics—EIR reset and the catch-up adjustment;

(c) an analysis of phrases used in paragraph B5.4.5 of IFRS 9—'floating rate' financial instruments and 'market rates of interest'; and

(d) three potential alternatives for clarifying paragraph B5.4.5 of IFRS 9.

Amortised cost and the effective interest method

23. In developing the IFRS 9 requirements for the solely payments of principal and interest (SPPI), the IASB discussed extensively the amortised cost as a measurement basis. Although these discussions focused on financial assets, some observations are also relevant to financial liabilities.

24. The IASB's long-standing view has been that amortised cost provides relevant and useful information about particular financial assets in particular circumstances because, for those assets, it provides information about the amount, timing and uncertainty of future cash flows. Amortised cost is calculated using the effective interest method, which is a relatively **simple measurement technique** that allocates interest over the relevant time period using the effective interest rate.[3]

[3] Paragraph BC4.171 of the Basis for Conclusions on IFRS 9.

25. For financial assets, the IASB believes that the effective interest method is suitable only for instruments with 'simple' cash flows that represent SPPI. In contrast, the effective interest method is not an appropriate method for allocating contractual cash flows that are not principal and interest on the principal amount outstanding. Instead, those more complex cash flows require a valuation overlay to contractual cash flows (ie fair value) so the reported financial information is useful.[4]

26. As an allocation mechanism, amortised cost works best for financial assets with contractual cash flows that are **fixed** (ie those that are known at contract inception and that are not contingent) both in timing and amount. Mechanically, it also works with **variable** contractual cash flows if those cash flows are reliably determinable. However, as the variability in contractual cash flows increases, amortised cost essentially ceases to allocate the effective return and increasingly becomes a **fair value-like measure**. In such cases, amortised cost does not provide superior information compared to fair value measurement. Furthermore, for such instruments, amortised cost loses the benefit of being a simple measurement technique and becomes increasingly more difficult to apply.[5]

27. Ultimately, amortised cost is a **cost-based measure**. This is reflected in the fact that the EIR is established at initial recognition, and it is updated only as noted in paragraph B5.4.5 of IFRS 9. In that sense, amortised cost is a measure of the amount invested in the financial asset at any given point in time that provides a link between the amount recorded on initial recognition and expected contractual cash flows. It is not a proxy for fair value. That is, amortised cost is not designed to—and does not—provide information about changes in fair value. [6]

[4] Paragraph BC4.172 of the Basis for Conclusions on IFRS 9.

[5] Paragraphs 14-17 of Agenda Paper 6B of the September 2013 IASB / FASB meeting.

[6] Paragraphs 10 and 25 of Agenda Paper 6B of the September 2013 IASB / FASB meeting.

The EIR reset vs the catch-up adjustment mechanism

28. There are two mathematical mechanisms that are used to ensure that the carrying amount of a variable rate instrument unwinds to the remaining expected cash flows:

    (a) **EIR reset**, ie paragraph B5.4.5 of IFRS 9, is an iterative calculation that changes the EIR such that the carrying amount will unwind to changed cash flow estimates; and

    (b) **Catch-up adjustment**, ie paragraph B5.4.6 of IFRS 9, is an adjustment recognised in profit or loss that changes the carrying amount so that the adjusted carrying amount will unwind to changed cash flow estimates.

29. Paragraph B5.4.5 of IFRS 9 applies to floating rate financial instruments whose estimated future cash flows are revised to reflect the movements in the market rates of interest—those are, market-based variable rate financial instruments. We note that the terms ‘market-based repricing’ and ‘market-based variable rate instrument’ are used in paragraph BCZ5.69 of the Basis for Conclusions on IFRS 9 and example B.24 of the Implementation Guidance of IFRS 9.

30. Applying paragraph B5.4.5 of IFRS 9 results in **periodic updates to the EIR** to reflect movements in the market rates of interest (ie when the market rates reset). Resetting the EIR means not recognising an adjustment in profit or loss immediately but rather recognising the change over the remaining life of the instrument.

31. In contrast, applying the catch-up adjustment mechanism in paragraph B5.4.6 of IFRS 9 relies on the **original EIR** determined on initial recognition to maintain a constant effective yield recognised as interest income or expense throughout the instrument’s life. The gross carrying amount of a financial asset, or the amortised cost of a financial liability, is adjusted cumulatively when expectations are revised. This adjustment is recognised in profit or loss immediately.

32. As noted in the Agenda Paper 8 of the October 2009 IASB meeting, the basic principle of amortised cost is using a present value calculation that discounts expected cash flows with the EIR. This means:

    (a) for a fixed rate instrument, using a **constant EIR**—the original EIR; and

    (b) for a variable rate instrument, using a **constant spread**. If the spread were reset then no element of the entire present value calculation would be fixed any more, neither the cash flows nor any component of the discount rate. Consequently, no input of the present value calculation would reflect the original conditions (ie those on initial recognition), which would be inconsistent with a cost-based measurement (see paragraph 27).

33. Therefore, resetting the entire EIR, ie including the spread, for variable rate instruments creates inconsistencies with the accounting for fixed rate instruments measured at amortised cost. For example, for a fixed rate instrument that is prepayable, a change in the prepayment estimate results in recognising a gain or loss by adjusting the carrying amount (a catch-up adjustment).

34. In contrast, for a variable rate instrument, a change in the estimated contractual cash flows would result in no gain or loss be recognised, assuming the entire EIR is reset and not just for the movements in the interest benchmark component.

35. The analysis presented in this section, alongside the principles of amortised cost and the effective interest method, indicates that the IASB has consistently regarded the catch-up adjustment—rather than a full EIR reset—as being more compatible with the amortised cost measurement.

36. Accordingly, it follows that application of the EIR reset mechanism to financial instruments measured at amortised cost (ie paragraph B5.4.5 of IFRS 9) was intended to be limited in scope rather than broadly applied.

37. This observation however differs from the 2025 outreach results, which show most entities commonly use the EIR reset mechanism. Many entities apply paragraph

B5.4.5 for nearly all changes in financial instrument interest cash flows, regardless of whether these changes reflect market terms.

38. In the 2025 outreach, participants did not elaborate why one mechanism more faithfully reflects the economics of a variable rate instrument or is operationally simpler.

39. However, we think EIR reset is preferred because participants consider it to be an overall better approach than catch-up adjustment. Firstly, the EIR reset avoids volatility in profit or loss that otherwise would result from recognising catch-up adjustments all at once, even though some of that adjustment relates to the interest income or expense that will only be recognised in future periods. Such volatility is often perceived as counterintuitive (or unnecessary). [7]

40. Secondly, it tends to be operationally simpler than the catch-up adjustment, which requires retaining the original EIR despite a change in the contractual interest rate, as well as recalculating the gross carrying amount of the financial asset or the amortised cost of the financial liability.

41. Furthermore, resetting the EIR aligns with the contractual interest payments or receipts. Contractual data are recorded in entities' customer management systems. Resetting the EIR to align to the contractual rate, removes the need to maintain parallel data only for accounting purposes (ie less systems changes required). Most of the 2025 outreach participants said that information from their customer management systems, which legally must be maintained according to the terms in the contracts with customers, are generally also used for accounting purposes.

[7] This is consistent with feedback the IASB previously received from stakeholders, as summarised in Agenda Paper 8 of the October 2009 IASB meeting.

Floating rate financial instruments

42. Paragraph B5.4.5 of IFRS 9 does not define or elaborate on what is meant by floating rate. However, it makes it clear that a financial instrument with variable contractual cash flows—which are periodically adjusted to reflect movements in the market rates of interest—is a floating rate financial instrument.

43. As noted in Agenda Paper 3B of the July 2022 IASB meeting, we think a helpful point of reference might be the adjacent paragraph, B5.4.4 of IFRS 9, that clearly distinguishes between market-based variables which are periodically reset or repriced to reflect movement in the market rates of interest and other variables that are not reset to the market rates. For example, that paragraph refers to the 'credit spread or other variables over the floating rate specified in the financial instrument which are not reset' as they do not reflect the movements in the market rate of interest.

44. This view is also consistent with the example B27 of the Guidance on Implementing IFRS 9 where the contractual terms specify the rate for a period of time and that rate varies every period. Even though the contractual cash flows are 'variable' over the life of the instrument, ie cash flows are fixed for only one period, the instrument is not considered a floating rate instrument because the contractual cash flows do not contain any parts that are reset to reflect the movements in the market rates of interest.

Market rates of interest

45. The contractual interest rate for a financial instrument typically consists of compensation for the time value of money, credit risk related to the outstanding principal over a given period, and other basic lending risks and costs. It may also include a profit margin or additional elements that align with the principles of solely payments of principal and interest. As noted in paragraph BC4.182(b) of the Basis for Conclusions on IFRS 9, consideration for the time value of money and the credit risk are normally the most significant elements of contractual interest.

46. Typically, an entity determines the price of a financial instrument based on the prevailing market rate of interest applicable to that instrument. The pricing process is specific to an instrument, as it generally involves evaluating a number of building blocks or risk components related to both general market-based variables—such as the benchmark interest rate—and additional factors unique to the transaction, such as a borrower-specific credit spread.

47. The sum of all identified pricing components equals the financial instrument's [prevailing] market rate of interest at initial recognition. This is the market rate of interest as described in paragraphs B4.3.8(b) or B5.1.1 of IFRS 9. This means the fair value, as defined in paragraph 9 of IFRS 13, of this particular financial instrument normally equals the transaction price.

48. All these interest rate variables or components might move after initial recognition. However, we think it is important to distinguish between:

    (a) **components that reflect movements in the general market conditions**. These include general market-based variables that reflect general market conditions (such as, benchmark interest rate or inflation rate). They affect equally all financial instruments referencing such a market-based variable.

    (b) **components that reflect movements in the overall market**. These include movements that reflect the general market-based variables as well as borrower-specific variables (such as, changes borrower's credit risk). These movements would reset the EIR, as a whole, to its prevailing market rate of interest. That is, the market rate for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating.

    (c) **components that reflect contractually specified changes, not market movements.** These include movements in a financial instrument's interest rate due to changes in any contractually specified variable, even if unrelated to prevailing market rates of interest. For example, credit ratchets or ESG-linked

features even if they adjust the contractual interest rate independently of prevailing market rates of interest.

Potential Alternatives

49. From the 2025 outreach and staff analysis, we identified three alternatives to clarify requirements in paragraph B5.4.5 of IFRS 9.

50. Paragraphs 51–71 provide the preliminary staff analysis regarding the advantages, disadvantages and effects to current practice for each alternative. Appendix A to this paper provides a table summarising these alternatives.

Alternative A

51. Under alternative A, paragraph B5.4.5 of IFRS 9 would apply solely to movements in contractual interest rates that are linked to general market-based variables, such as the benchmark interest component or inflation rate. Under this alternative, paragraph B5.4.5 of IFRS 9 would not apply to movements linked to borrower-specific factors, such as the credit spread.

52. The alternative aims to keep most elements of financial asset or liability calculations fixed, reflecting the conditions on initial recognition of a financial instrument. EIR would only be updated to reflect movements in the market rates of interest resulting from market wide changes. These market changes would be readily observable and reflective of general market conditions not individual borrower circumstances.

53. The main advantages of Alternative A are that it is:

    (a) more aligned with amortised cost being a cost-based measure, because only specific components of a contractual interest rate would be repriced to market. Most elements in the calculation of the gross carrying amount of a financial asset or the amortised cost of a financial liability would continue to reflect historic or original conditions as in the initial recognition of the instrument.

This also maintains consistency with accounting for fixed rate instruments measured at amortised cost.

(b) based purely on observable inputs, reducing subjectivity. Under this alternative EIR would only be updated for changes in general market conditions, which are observable, market-based inputs. That is, this approach would not require updating the EIR using unobservable or borrower specific inputs.

(c) consistent with previous IASB views on the application of paragraph B5.4.5 of IFRS 9. For example, it would be consistent with:

(i) the distinction made in the adjacent paragraph, B5.4.4 of IFRS 9, between market-based variables that reflect movements in the market rates of interest and other variables, such as credit spread, that are not reset to market (see paragraph 43). This means that clarifying paragraph B5.4.5 of IFRS 9 as set out in Alternative A would also result in alignment between paragraph B5.4.5 and paragraph B5.4.4 of IFRS 9.

(ii) the application guidance in the 2009 Exposure Draft. As summarised in the background section of this paper, the catch-up adjustment mechanism would generally have been required when accounting for changes in expected cash flows. However, for a floating rate financial instrument that resets to a benchmark interest rate, periodic re-estimation of cash flows to reflect changes in the benchmark interest rate would alter the EIR.

54. We think the main disadvantages of Alternative A are that:

(a) it could result in recognition of catch-up adjustments for all movements in contractual interest rates of financial instruments, other than those linked to the general market-based variables. As noted in paragraph BC4.233 of the Basis for Conclusions on IFRS 9, the IASB previously noted that frequent upward and downward adjustments recognised in financial statements might, over time, reduce the usefulness of information to users of financial statements (investors).

(b) more movements in contractual interest rates being accounted for using the catch-up adjustment mechanism would also lead to increased operational costs for preparers, including system changes (see paragraph 41).

55. In terms of potential effects, Alternative A could result in significant consequences (ie major changes to current practices and potentially significant operational costs). As noted in paragraphs 13–18, outreach showed that most changes in contractual interest rates are currently accounted for by applying paragraph B5.4.5 of IFRS 9. Only a few outreach participants applied this paragraph exclusively to changes in the benchmark components of interest rates, which would be aligned with Alternative A.

56. Furthermore, it is not clear whether the information resulting from this approach would always be useful to investors (see paragraph 54(a)).

57. In conclusion, Alternative A might be a reasonable approach to clarifying the application of paragraph B5.4.5 as it is most consistent with the basis of amortised cost measurement, uses only market observable inputs, and aligns with previous IASB discussions. However, given its potential effects, we think that, without any adjustments, the application costs may exceed the benefits of the resulting information.

Alternative B

58. Under Alternative B, paragraph B5.4.5 of IFRS 9 would apply to movements in contractual interest rates that are linked to any changes in market variables (both general market and borrower-specific rates). This means, the contractual interest rate as a whole might be reset or repriced to its prevailing market rate of interest.

59. Alternative B would therefore mean an entity applies paragraph B5.4.5 of IFRS 9 to account for market resets or repricing of all components of an interest rate, ie both the general market-based elements (such as interest benchmark component) as well as the borrower specific elements (such as the credit spread).

60. This alternative aims to reset the EIR to its prevailing market rate of interest. In this context, the term 'market rate of interest' in paragraph B5.4.5 of IFRS 9 would be linked to the concept of fair value defined in IFRS 13 and as described in paragraph B5.1.1 of IFRS 9 as the rate of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating.[8]

61. The main advantages of Alternative B are that:

(a) it uses fair value, a familiar concept, to measure interest cash flows. Linking the term 'market rate of interest' to the concept of fair value as defined in IFRS 13 would leave less room for interpretation of its meaning, potentially achieving a more consistent application.

(b) consistent with how 'market rates of interest' is used in some parts of IFRS 9. For example, paragraph B5.1.1 of IFRS 9 which refers to the 'prevailing market rate(s) of interest' used to determine the fair value of a financial instrument at initial recognition.

(c) compared to Alternative A, this results in fewer significant adjustments to financial assets or liabilities and smaller gains or losses in profit or loss, since more changes in contractual interest rates are accounted for under paragraph B5.4.5. Although this approach may mitigate some consequences outlined in paragraph 54(a), resetting the EIR to align with its prevailing market rate could still result in frequent recognition of gains or losses as market rates fluctuate. However, such adjustments would be generally less significant than those arising from catch-up adjustments applying paragraph B5.4.6 of IFRS 9.

62. The main disadvantages of Alternative B are that:

[8] This approach would be consistent with the agenda decision of the IFRS Interpretations Committee published in January 2016. In this agenda decision, the Committee noted that the term '**market rate of interest**' is linked to the concept of fair value as defined in IFRS 13 and is described in paragraph AG64 of IAS 39, replicated in paragraph B5.1.1 of IFRS 9, as the rate of interest 'for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating'. The Committee also observed that paragraphs B4.3.8(b) and B5.1.1 of IFRS 9 replicate the requirements of paragraphs AG33(b) and AG64 of IAS 39. Consequently, the observations noted in this agenda decision would be equally applicable to financial liabilities accounted for in accordance with IFRS 9.

(a) it might lead to counterintuitive outcomes and ambiguous information for investors. Paragraph B5.4.5 sets requirements for financial instruments measured at amortised cost. Requiring an entity to measure interest cash flows of such an instrument at fair value contradicts its classification as measured at amortised cost.

(b) it lacks conceptual basis because resetting the EIR to its prevailing market rate of interest is inconsistent with amortised cost, which is intended to be a cost-based measure. This approach also differs from fair value measurement, as only some cash flows—specifically, interest cash flows—would reflect fair value, while the rest of an instrument's cash flows would remain measured at amortised cost. Such a practice would result in a hybrid measurement model between amortised cost and fair value. In previous projects investors have been against developing a new measurement basis, with most expressing that a 'full' fair value is more understandable and useful than an 'adjusted' fair value amount.[9]

(c) it requires measuring interest cash flows at fair value for instruments which are otherwise measured at amortised cost and this would often require using non-observable inputs. For example, determining prevailing market rates of interest for retail loans might often require unobservable inputs. A quoted interest rate in an active market for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit risk may not exist or be accessible for every case.

(d) it might significantly increase operational costs for preparers to determine the prevailing market rate of interest for large portfolios of financial assets and financial liabilities. It might also result in increased costs for investors to analyse information resulting from this new and hybrid measurement basis.

[9] See paragraph BC4.49(d) of the Basis for Conclusions on IFRS 9.

63. In terms of potential effects, Alternative B might lead to less significant changes in practice compared to Alternative A. As noted in paragraph 15, some entities already assess if a change in the contractual interest rate effectively resets the entire interest rate of a financial instrument to its prevailing market rate of interest. Alternative B may align with these practices.

64. This alternative would, however, exclude the movements in contractual interest rates resulting from pre-determined adjustments, such as credit ratchets, step-up rates, or ESG-related adjustments, if they change the contractual interest rate to non-market rates (ie change it independently of market rates prevailing at the time the contingent event occurs).

65. In conclusion, Alternative B offers some advantages over Alternative A, such as clarifying paragraph B5.4.5 of IFRS 9 by linking it to the concept of fair value in IFRS 13, which might reduce the potential for different interpretations and achieve a more consistent application. However, measuring interest cash flows at fair value for financial instruments classified at amortised cost could be conceptually flawed and not result in useful information for investors.

Alternative C

66. Under Alternative C, paragraph B5.4.5 of IFRS 9 would apply to any changes in a contractual interest rate that result from contractually specified variables, regardless of the movements in market rates of interest. This alternative would therefore update the EIR even for changes that adjust the contractual interest rate independently of market rates prevailing at the time the contingent event occurs.

67. The aim of this alternative would be to update the EIR to ensure it is consistent with the contractual interest payments or receipts, as and when they happen. To some extent, this alternative would result in an approach that is similar to cash accounting.

68. The main advantage of Alternative C is being operationally simple and aligned with contractual amounts. This may mean potentially less system changes required,

because interest income or expense would be recognised in financial statements based purely on contractual information. There would be no calculation of the effective return on a financial instrument, no estimation involved. Similarly, there would no assessment against the movements in the prevailing market rates of interest.

69. The main disadvantages of Alternative C are that it is:

(a) inconsistent with the basis of amortised cost which is calculated using the effective interest method. The effective interest method is essentially a **spreading mechanism** that allocates interest revenue or interest expense over a relevant period, and in doing so, amortises or accretes the carrying amount recognised on initial recognition to the ultimate contractual cash flows. The EIR as defined in IFRS 9 results in the recognition of the **effective return** on a financial instrument **in profit or loss** over time as the difference between the amount recognised on initial recognition and the expected contractual cash flows. The effective interest method is therefore inconsistent with a basis that is akin to cash accounting, since this results in recognition in profit or loss of interest changes as and when they happen, not an effective return.

(b) entirely inconsistent with the explicit reference in paragraph B5.4.5 of IFRS 9 to the movements in **market rates of interest** as those that alter the EIR. It is thus clear that movements that are not reflective of market rates are excluded from paragraph B5.4.5. These are other revisions of estimated payments or receipts which are required to be accounted for applying paragraph B5.4.6 of IFRS 9. Further, both paragraphs B5.4.5 and B5.4.6 talk about revised estimates of payments or receipts. Alternative C involves no estimation per se.

70. In terms of potential effect, Alternative C is likely to require the least change in practice when compared to Alternative A and Alternative B, as it would effectively mean that any change in the contractual interest rate is accounted for applying paragraph B5.4.5 of IFRS 9. This would more closely align to current practices.

71. In conclusion, Alternative C is operationally simple, aligns with contractual payments or receipts, and in some cases would result in accounting outcomes consistent to current practice. However, in our view, this alternative is similar to cash accounting and, as such, it is incompatible with accrual basis of accounting.

Staff preliminary views

72. Our preliminary analysis provides three distinct approaches, each at opposite ends of a broad spectrum, as also illustrated in Appendix A.

73. There may be other possible alternatives, combining elements of approaches A–C, that better balance costs and benefits. However, to explore those additional alternatives we would ask for some direction from the IASB, including whether:

    (a) you have identified any variations to alternatives A–C that could more effectively balance costs and benefits; or

    (b) any of the alternatives presented in this paper should be excluded from further consideration in their current form.

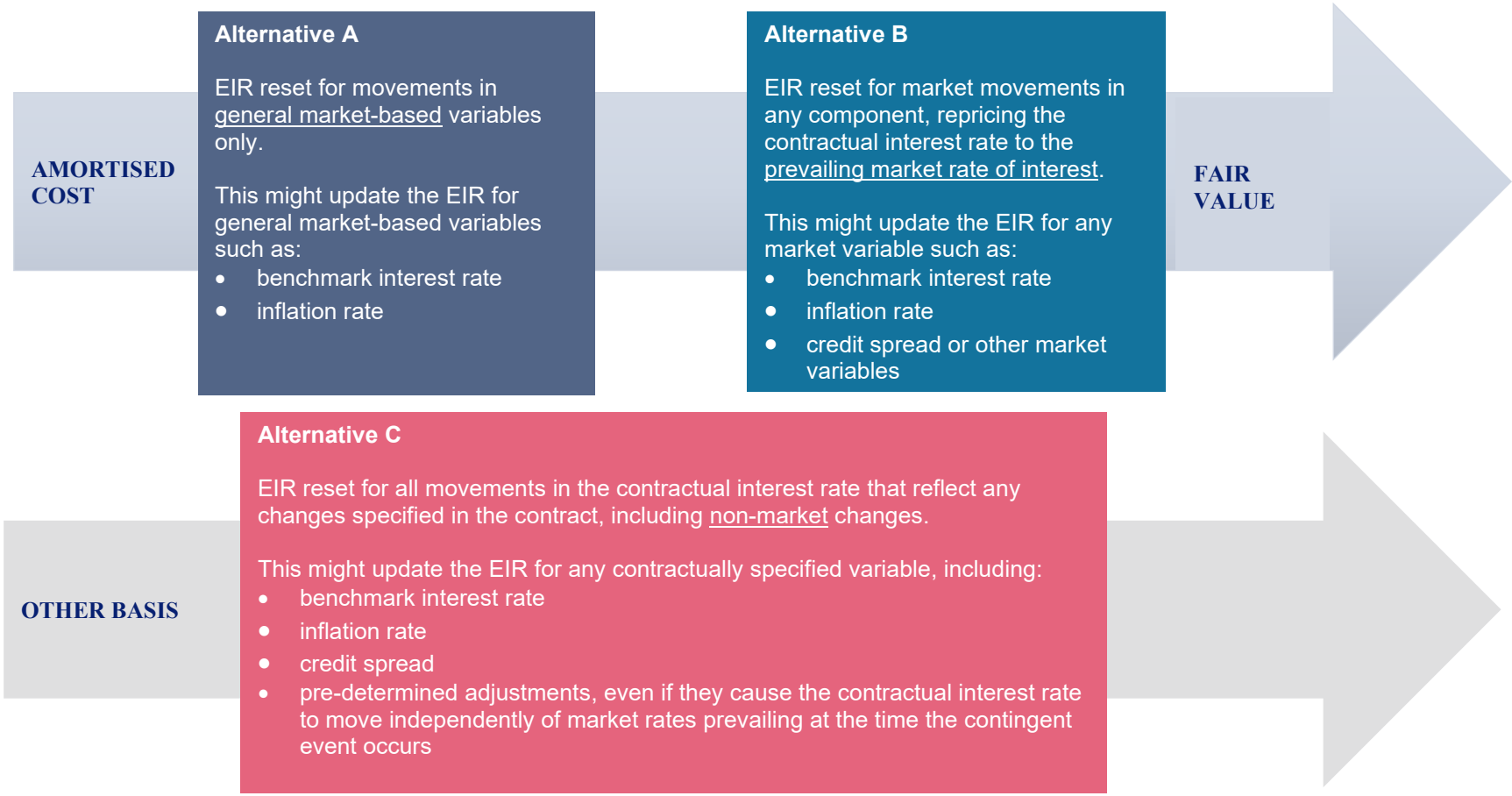
74. At future meetings, we also plan to discuss in detail the usefulness of information that results from paragraph B5.4.6 of IFRS 9, which applies to all the revisions of estimates of payments or receipts that fall outside of paragraph B5.4.5.

75. For instance, we aim to analyse when retaining the original EIR, despite changes in contractual interest rate, provides useful information, and what information is conveyed by adjusting the amounts of financial assets or liabilities in statement of financial position and recognising immediate gains or losses in profit or loss.

76. This additional analysis might also assist the IASB in evaluating the alternatives for clarifying the application of paragraph B5.4.5 of IFRS 9.

Appendix A—Illustration of potential alternatives

A1. The following illustration summaries alternatives A—C discussed in paragraphs 51–71 of this paper.



Appendix B—Review of accounting firms' manuals

B1. We reviewed the accounting manuals of the large accounting firms to collect information about their views relating application of paragraph B5.4.5 of IFRS 9.

B2. Generally, the accounting firms acknowledged that IFRS 9 does not define the terms 'floating rate' financial instrument or 'market rates of interest'.

B3. One accounting firm did not provide additional comments, while others stated:

(a) one firm said that 'market rates of interest' comprise different components, typically, the time value of money as represented by a benchmark rate; credit and other spreads; and a profit margin. So, if the contract provides for the cash flows of an instrument to be reset to reflect changes in any or all these components, paragraph B5.4.5 of IFRS 9 applies to all those changes.

(b) one firm explained that B5.4.5 of IFRS 9 is considered appropriate not only for instruments whose contractual rates vary with observable benchmark rates but also for those with features that cause the interest rate to reset to a current market rate. Examples included benchmark-linked coupons, inflation-indexed principal and interest, variable credit-spread 'margin ratchets', or ESG-linked adjustments that mirror changes in the issuer's market credit spread. Given the lack of guidance in IFRS 9, entities must make a consistent accounting policy choice on whether instruments with features such as adjustable credit spreads, inflation linkage or ESG factors qualify for accounting under paragraph B5.4.5 of IFRS 9. The chosen policy should be applied consistently and disclosed.

(c) one firm mentioned that judgement may be required in interpreting these terms to different circumstances. In many cases, a floating rate instrument may have a contractual interest rate that comprises more than one component such as a published benchmark rate (eg Euribor) or other published interest rate index and a specified spread (eg a predetermined percentage spread above Euribor). Generally, changes in the benchmark rate would be considered a change to which paragraph B5.4.5 of IFRS 9 applies.