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Amortised cost measurement

Cover Note

Objective

1 The objective of this session is to obtain views of EFRAG FR TEG - CFSS members concerning the project objectives and the approach, the completeness of the list of issues as currently identified by the IASB, any initial advice about supporting stakeholders throughout this project and any other observations at this stage of the project. This feedback is intended to be provided at the ASAF meeting on 5-6 December 2024.

Background

2 In September 2024 the IASB made *the Amortised Cost Measurement* an active project moving it from the research pipeline to the research work plan.

3 The IASB has recently undertaken post-implementation reviews ('PIR') of the classification and measurement as well as the impairment requirements of IFRS 9. The key message from the stakeholders is that the classification and measurement requirements as well as the impairment requirements of IFRS 9 work well in practice, with no fundamental questions in their core objectives or principles. Accordingly, stakeholders did not suggest fundamental review or changes to these requirements.

4 Therefore, the purpose of *the Amortised Cost Measurement* project is to resolve application questions and challenges associated with the amortised cost measurement requirements of IFRS 9, taking into account both recent PIRs and previous history of addressing the accounting challenges concerning the measurement of amortised cost.

5 Accordingly, in the IASB staff's view, the most appropriate approach for this project would be a 'targeted improvements' approach. The IASB staff considered but rejected several alternative approaches, namely those representing (i) a fundamental review of the amortised cost measurement requirements, (ii) narrow-scope amendments and (iii) disclosure-only approach.

6 The key features of the 'targeted improvements' approach have been summarised in the recently published agenda paper for the ASAF December 2024 meeting as follows (emphasis in bold by the IASB staff):

(a) Responsive to stakeholders' feedback;

(b) Designed to be a **principle-based approach;**

(c) Focus on **root causes underlying the issues**, not on particular features or types of financial instruments;

(d) A clear starting point, i.e. the known application issues as expressed by stakeholders over time, and the current requirements of IFRS 9.

7 When defining the criteria to determine the scope of the project, the IASB noted that the IASB should explore solutions for issues:

(a) that are widespread and have, or are expected to have, a material effect on those affected;

(b) for which financial reporting would be improved through clarifications to reduce the diversity in practice;

(c) for which the benefits from the resulting information are expected to exceed the operational costs; and

(d) that can be resolved by the IASB efficiently and effectively without (i) fundamentally rewriting the requirements of IFRS 9; (ii) creating internal inconsistencies in IFRS 9; and (iii) amending other IFRS Accounting Standards.

8 The IASB staff summarised an initial list of project topics in Appendix A to the IASB agenda paper AP11 which was presented at the IASB September 2024 meeting.

9 The IASB staff is currently working on the project plan on which they intend to decide in February 2025 (as indicated in the staff paper for the ASAF meeting in December 2024). For this purpose, they plan to consult with stakeholders, including seeking input from ASAF at the December 2024 meeting and from IFRS IC at the November 2024 meeting.

Key areas and sources of the project

10 Appendix A to the IASB agenda paper AP11 (September 2024) identifies 11 topics, grouped into the following areas:

(a) Mechanics of effective interest rate method;

(b) Modification, derecognition, write off;

(c) Interaction with impairment.

11 The IASB emphasises that whilst the *Amortised Cost Measurement* project is a result of the two PIRs of IFRS 9, the issues reported through these PIRs have not only arisen in practice since IFRS 9 was issued but have a long history, dating back to 2008. Stakeholders have raised such issues in several other projects of the IASB or the IFRS Interpretations Committee, most notably:

(a) Exposure Draft *Financial Instruments: Amortised Cost and Impairment* (2009);

(b) Agenda decision: *Derecognition of financial instruments upon modification* (2012);

(c) Interest Rate benchmark Reform – Phase 2 (2019-2020);

(d) TLTRO III transactions (2021).

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12 The IASB was not asked to make any tentative decisions but rather to share their views concerning the project, notably the approach proposed by the IASB staff.

13 In general, the IASB agreed with the proposed approach (‘targeted improvements’) and criteria. However, some members noted that it may be useful to provide a clearer explanation to the wider audience to articulate the difference between ‘targeted improvements’ and ‘narrow-scope amendments’’ in order to avoid possible confusions.

14 Several members noted that an important task of the project will be not only reducing diversity in practice but also understanding **root causes** of the existing diversity. Also, some members observed that eliminating all of the existing diversity should not be the target and, on the other hand, reducing diversity may result in changes to existing practices which may be undesired by the some of the stakeholders impacted.

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15 Members confirmed their agreement that the list of issues identified by the IASB staff in Appendix A to the IASB agenda paper AP11 presented at the IASB September 2024 meeting is comprehensive.

16 Several members confirmed the two topics previously identified as priorities, namely:

(a) Application of IFRS 9.B5.4.5 vs IFRS 9.B5.4.6;

(b) Application of modification vs derecognition requirements (e.g., consequences in the context of commercial restructuring or forbearance).

17 On the contrary, some other members noted that the current stage of the project may be too early to identify priorities.

18 Some members noted that it would not be appropriate to refer to existing simplifications in the calculations of the amortised cost as immaterial as they may, in fact, have a significant impact, especially on a portfolio basis.

19 Members confirmed their agreement with the general approach proposed by the IASB (targeted improvements). Members emphasised the importance of prudence in introducing changes to the existing practice and agreed that the approach should be principle-based as proposed by the IASB. Some members noted that given the relative simplicity of the systems currently used to calculate the amortised cost, introduction of significant changes may result in considerable costs and difficulties for preparers, while, in their view, cost/benefit considerations should be the key element in introducing the changes. Some members emphasised that solutions concerning the amortised cost measurement should be pragmatic to avoid unnecessary disruptions of the existing practice, rather than ideal from a purely technical point of view.

20 Several members noted that previous work on the topics mentioned by the IASB staff (e.g., TLTRO III, IBOR) should be used a source for the current project and may give rise to a clearer guidance to be provided.

21 Members noted the importance of users' feedback for the project in order to conclude how the amortised cost information is used.

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22 Many members agreed that the list the issues to be included in the scope of the project as identified by the IASB staff in Appendix A to the IASB agenda paper AP11 presented at the IASB September 2024 meeting is comprehensive.

23 One member suggested to include the issue of whether one should use forward rates to discount future cash flows from financial instruments with floating interest rates (though the member expressed a view that such an approach could be overly sophisticated). Other members, while agreeing in principle that this topic should be addressed, observed as well that it may be already included in some other topics of the IASB staff's list of issues.

24 In terms of prioritisation, several members mentioned that they would prioritise the issue of applying IFRS 9.B5.4.5 vs IFRS 9.B5.4.6. One member further elaborated that, in his view, the second most significant issue would be when modification triggers derecognition (e.g., consequences in the context of commercial restructuring or forbearance).

25 Members agreed, in general, with the 'targeted improvements' approach and suggested that it would be worth explaining the difference between 'targeted improvements' and 'narrow-scope amendments' as proposed by the IASB at their September 2024 meeting.

26 Several members noted that any changes should be introduced in a very prudent manner in order to avoid significant costs for the preparers.

EFRAG Secretariat analysis

Project objectives and approach

27 The EFRAG Secretariat generally agrees with the 'targeted improvements' approach as proposed by the IASB staff and shares the views that fundamental changes in the requirements over amortised cost measurement are not needed.

28 The EFRAG Secretariat is of the view that amortised cost measurement should remain a simple calculation method and is not in favour of developing sophisticated calculations with multiple scenarios. The EFRAG Secretariat agrees with the views of the IASB staff that the key feature of the project is that the approach to the identified issues should be principle-based, thus avoiding too specific guidance.

29 The EFRAG Secretariat agrees with the IASB staff in identifying the root causes of the issues rather than particular features or types of financial instruments as an important basis of the IASB's approach.

30 Any changes should be introduced with prudence, with the risk of unintended consequences, generally, being considered as more significant than benefits of eliminating the existing diversity in practice.

31 Amortised cost is an accounting calculation and not a reflection of an economic phenomenon.

32 Adding any new simplifying assumptions might increase the risk of internal inconsistencies within IFRS 9.

33 The EFRAG Secretariat notes that as soon as amortised cost has to be calculated in an accounting (or accounting support) system, then operational costs relate more to the set-up of the system rather than to the ongoing operation of the system. When considering operational costs for calculating amortised cost, costs to produce accompanying disclosure requirements must also be considered.

Scope

34 The EFRAG Secretariat notes that the list of issues summarised in Appendix A of the IASB agenda paper AP11 fairly represents the feedback received from the stakeholders during

both PIR, including issues raised by EFRAG, such as for example absence of a definition of 'substantial modification' and application challenges of EIR method when part of the contractual cash flows is either not certain to occur and/or their timing of occurrence is uncertain. EFRAG in its final comment letter on the PIR of classification and measurement requirements of IFRS 9 recommended to monitor how practice will develop, in particular when applying B5.4.5 and subsequent paragraphs.

35 The EFRAG Secretariat observes that often the most important issue related to amortised cost is the scope i.e. whether or not to measure financial instruments at amortised cost rather than how to calculate it.

36 The EFRAG Secretariat emphasises the need to consistently apply the terminology related to effective interest rates (e.g. 'original' vs 'recalculated', 'altered' effective interest rate).

37 The EFRAG Secretariat notes that interaction between amortised cost measurement and hedge accounting requirements could give rise to further issues. Such issues could be addressed in the scope of another project, e.g. the upcoming post-implementation review of IFRS 9 hedge accounting requirements, without including this topic in the list of issues as identified by the IASB in the scope of the current project.

Questions to EFRAG FR TEG – CFSS

Project objectives and approach

38 What is your assessment of the project objectives and the approach?

(i) Whether the project objectives and the approach adequately respond to stakeholder concerns and allow timely progress?

(ii) Have you identified any specific areas relating to amortised cost measurement for which information provided to investors could be significantly improved?

Scope

39 What is your assessment of the project scope? Is the list of project topics broadly complete? Have you identified any issues missing from that list that are widespread in your jurisdiction and have a material effect in the financial statements?

Supporting stakeholders

40 Any initial advice about supporting stakeholders throughout this project? How can the IASB best support stakeholders that will be affected by this project, including any specific tools or resources to consider from the onset?

Other matters
41 Any other matters? Do you have any observations on other aspects of this project?

Next steps

42 Following the today's discussion, the EFRAG Secretariat will present the feedback received at the ASAF December 2024 meeting.

Agenda papers

43 In addition to this cover note, agenda papers for this session are:

(a) Agenda paper 08-02 – ASAF December 2024 paper *Amortised Cost Measurement: Project objectives and scope* - for background