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Determining effective interest rate at initial recognition

Issues Paper

Objective

- 1 The objective of this session is to discuss with EFRAG FR TEG the IASB analysis of the feedback received from the outreach activities, [the IASB staff paper AP11A](#) to the September 2025 IASB meeting and the IASB's tentative decisions on determining effective interest rate (EIR) at initial recognition.

Background

- 2 As advised by the consultative groups, in March – May 2025 the IASB staff conducted several outreach events with groups of stakeholders from various industries and regions. In total the IASB held 10 outreach events with 90 individual entities, over 60 per cent of which were preparers. For more information, please refer to the [Appendix A of the IASB AP 11A](#).
- 3 The questions were divided in three main topics, Topic 1 being determining EIR at initial recognition, notably accounting for conditionality in contractual cash flows.
- 4 The main purpose of the outreach events was to gather information about the root causes of potential diversity in application of the amortised cost measurement requirements.
- 5 The following terms in this agenda paper broadly indicate the portion of outreach participants that reported a particular view:
 - (a) almost all - all except a very small minority;
 - (b) most - large majority, with more than a few exceptions;
 - (c) many - small majority or large minority;
 - (d) some - small minority, but more than a few; and
 - (e) a few - a very small minority.

Calculating the EIR on initial recognition

Outreach feedback

- 6 The feedback was mostly provided with the reference to the following contractual terms and conditions: credit ratchet, stepped interest and ESG-linked features.
- 7 Generally, outreach participants acknowledged that the definition of the EIR as set out in Appendix A of IFRS 9 makes it clear that an entity is required to reflect **all the contractual terms and conditions** of an instrument in estimating expected cash flows for purpose of

calculating EIR at initial recognition of a financial instrument, i.e. including any conditional terms that might change the contractual interest rate.

- 8 However, many outreach participants said that they reflect **some, but not all**, conditional terms when calculating EIR. Others, including two global banks, said that they do not reflect any conditional terms. They only recognise changes in cash flows from those terms when the contingent event occurs.
- 9 These participants noted either materiality judgements or insufficient information available (e.g. lack of historical data) to support a reliable estimate as reasons for not reflecting conditional terms. These participants did not specify whether entities, such as lenders, actually analyse the expected effects of conditional terms over the lifespan of a financial instrument for internal purposes, such as in pricing the financial instrument.
- 10 The outreach participants who reflect some, but not all, terms into the calculation of EIR, acknowledged that their accounting policies lack a conceptual rationale. In describing their policies, they typically specified which terms and conditions are reflected in the calculation and which are not. For example, some financial institutions in Europe said that they do not reflect the ESG-linked features in calculating EIR at initial recognition because they consider their impact to be immaterial at this time. However, they note that these effects might become material in the future.
- 11 Overall, most outreach participants said that collecting and storing information for the EIR calculation is typically not integrated into the core systems of an entity.
- 12 The participants that reflect conditional terms in the EIR calculation said that they use either of the following methods, depending on facts and circumstances:
 - (a) **the most likely outcome** - the single most likely outcome in a range of possible outcomes. This is the most common method used among both financial and non-financial institutions. This method requires estimation on an individual financial instrument basis (i.e. it is less suitable for a collective estimate).
 - (b) **the probability-weighted amounts (expected value)** - based on a range of possible outcomes. This method is applied primarily in context of collective estimates when there is a range of possible outcomes that are neither binary nor concentrated on one outcome (it is used for example, for retail loan portfolios to estimate the probability that the prepayment feature will be exercised).
- 13 Most outreach participants were of view that the IASB should not require a specific method as it depends on specific facts and circumstances. A few respondents suggested that any potential clarifications should be consistent with principles in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* or in IFRIC 23 *Uncertainty over Income Tax Treatments*¹.

¹ Paragraphs 39–40 of IAS 37 provide principles about determining a best estimate in context of the amount recognised as a provision, stating that uncertainties surrounding the amount to be recognised as a provision are dealt with by various means according to the circumstances. Methods of estimation such as probability-weighting, the mid-point of the range, or the most likely outcome are mentioned alongside circumstances where their use would be appropriate for purpose of determining the best estimate of the liability. Similarly, paragraph 11 of IFRIC 23 requires that an entity reflect the effect of uncertainty for each uncertain tax treatment by using either the most likely amount or the probability-weighted method, depending on which method the entity expects to better predict the resolution of the uncertainty.

The IASB staff analysis and recommendation

- 14 The root causes of diversity in calculating the EIR on initial recognition were identified as development by entities of **'simplified' accounting policies** that align with their system capabilities.
- 15 The IASB staff noted that although there are differences in how entities apply these requirements, **standard-setting might not effectively resolve these differences**. That is because:
- (a) The differences regarding whether and which conditional terms entities consider in the EIR calculation **are not attributable to unclear requirements**. The definition of EIR in Appendix A of IFRS 9 Financial Instruments is clear, all contractual terms and conditions shall be considered, except in rare cases when it is not possible to reliably estimate the cash flows or the expected life of a financial instrument; in such cases, contractual cash flows are used. Outreach findings indicate that entities not considering conditional terms in the EIR calculation **often do so due to materiality assessments or insufficient information available for a reliable estimate**.
 - (b) Although IFRS 9 does not prescribe methods for considering conditional terms in the EIR calculation, outreach findings indicate that entities use judgment to select appropriate methods based on relevant facts and circumstances, often applying other IFRS Accounting Standards by analogy. As a result, **clarifications in this area may not lead to substantial improvements in financial reporting**.
- 16 Therefore, **the IASB staff recommended that the IASB take no further action regarding the application issues that arise in determining the EIR at initial recognition** for financial instruments with conditions attached to the contractual interest rate.

The September 2025 IASB meeting

- 17 The IASB discussed whether to clarify how an entity applies the requirements in IFRS 9 *Financial Instruments* on determining the EIR if a financial instrument has conditions attached to the contractual interest rate. Specifically, it discussed:
- (a) which conditional terms an entity is required to consider in estimating the expected cash flows for the purpose of calculating the EIR; and
 - (b) which estimation methods an entity is required to use in calculating the EIR.
- 18 **The IASB tentatively decided to take no further action on this matter.**
- 19 All 12 IASB members agreed with this decision.

FIWG meeting on 13 October 2025

- 20 Members did not have significant additional comments.

FIWG meeting on 9 September 2025

- 21 Members generally agreed with the IASB staff analysis that the standard-setting might not be needed for this topic.

The EFRAG Secretariat assessment

- 22 The EFRAG Secretariat reiterates that amortised cost should remain simple measurement method and any potential clarifications should be carefully assessed against cost-benefit balance and whether and to what extent it affects the established practice. Therefore, in the view of the outreach feedback and the IASB staff analysis of the root causes, the EFRAG

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Secretariat agrees with the IASB's tentative decision to take no further action on this matter.

Questions to EFRAG FR TEG

- 23 Do you have any comments on the IASB staff feedback analysis of the outreach feedback received and on the IASB's tentative decisions? Please explain.