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Modification of financial instruments - analysis of the outreach feedback

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 on modification of financial instruments and other issues.

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 and asked how do entities, Topic 3 being accounting for a modification applying IFRS 9 and the underlying rationales. Specifically:
 - (i) do they distinguish between a ‘change in contractual terms’ and a ‘change in the contractual cash flows’ for purpose of applying IFRS 9?
 - (ii) how do they assess whether a modification is substantial leading to derecognition of a financial instrument? When is the ‘ten per cent test’ used for this assessment? Does the assessment approach differ between that for financial assets and that for financial liabilities?
- 4 The IASB also asked for any other matters where entities face significant challenges or observe significant diversity relating to application of the amortised cost measurement requirements in IFRS 9.
- 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.

Feedback summary

- 6 Overall, the outreach feedback confirms that there is significant diversity in application of requirements on amortised cost measurement. Most preparers in the outreach describe their current practices with reference to specific features or types of financial instruments, rather than identifying a consistent principle or rationale.
- 7 The IASB staff described the root causes of diversity in application were identified for topic 3 and other topics as **IFRS 9 having no explicit requirements or application guidance, leading entities to develop their own accounting policies.**

Modification of financial instruments

Outreach feedback¹

What constitutes a 'modification'?

- 8 Outreach feedback suggests that despite the difference in wording between paragraphs 3.3.2 and 5.4.3 of IFRS 9, there is no diversity in practice regarding what constitutes a modification of a financial asset or liability. All outreach participants said that the trigger for a modification is a change in contractual terms, i.e. only the changes that arise from bilateral agreement between counterparties.
- 9 They expressed concerns if modifications would include changes in contractual cash flows if the terms of the contract remain unchanged (e.g. changes in cash flows arising from in-contract covenants being triggered). In their view this would significantly increase operational costs.

How to determine whether a modification results in derecognition?

- 10 Almost all outreach participants considered that assessing whether a modification is substantial is the area with the greatest diversity in application. They attributed this diversity to insufficient guidance in IFRS 9 and the guidance being asymmetrical between financial assets and financial liabilities.
- 11 The following practices for the modification assessment on **financial liabilities** were described:
 - (a) some participants first do the ten per cent test (paragraph B3.3.6 of IFRS 9) and, if it is not met, then they also do a qualitative analysis (for example, assessing if terms such as maturity or currency have been changed). Other participants perform qualitative analysis regardless of the outcome of the ten per cent test.
 - (b) a few participants rely solely on the ten per cent test, without any further qualitative assessment.
 - (c) some participants reported varied practices regarding which cash flows are included in the ten per cent test. For example, some include in the test cash flows relating to terms such as extensions, others exclude such terms.
- 12 The following practices for the modification assessment on **financial assets** were described:
 - (a) some participants 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).

1 For more information, please refer to the [Appendix A of the IASB AP 11A](#) paragraph 29-44.

- (b) a few participants apply the ten per cent test in addition to the qualitative test.
 - (c) some financial institutions developed their own accounting policies. They determine the accounting outcomes based on the staging of the modified financial asset for expected credit losses (ECL) and the reason behind its modification:
 - (i) if a modified financial asset is classified in stage 1 (performing) for ECL purposes, they would deem it as a **substantial modification** and account for it by derecognising the original asset and recognising a new on-market asset. In their view, the modification of a performing financial asset is equivalent to the prepayment of the original asset and issuance of new asset at the prevailing market terms, and therefore the accounting outcome must align to that of a newly originated asset.
 - (ii) 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 or not account for such a modification at all. They reasoned that those modifications are typically due to deterioration of the borrower's credit risk and as such the effects have essentially already been accounted for as ECL. Bypassing the modification assessment for stage 2 and 3 financial assets ultimately aims to avoid a 'reset of ECL stages' which is consistent with regulatory guidelines. Specifically, this practice aims to avoid instances where a modification of, for example, a stage 3 loan results in derecognition of that loan and recognition of a 'new' stage 1 loan.
- 13 Most outreach participants asked for clarifications and additional application guidance on performing the modification assessment. Some suggested the clarifications be principle-based, for example, in the form of qualitative factors that entities are required to consider in assessing whether a modification results in derecognition. Others asked the IASB to specify:
- (a) how to do the modification assessment for a financial asset. A few of these participants suggested the assessment to be based on the reason for a modification - commercial reasons versus those due to deterioration of credit risk.
 - (b) how to perform the 'ten per cent test', including clarifying which cash flows are included in this test (for example, whether potential extensions should be reflected in the discounted present value of cash flows).
 - (c) how to do the modification assessment for revolving credit facilities, such as credit cards and overdraft facilities as it is particularly challenging.

The IASB staff analysis

- 14 The IASB staff considers that the root cause for the diversity in application of the modification requirements is the lack of explicit requirements or sufficient application guidance, particularly for financial assets in IFRS 9.
- 15 The IASB would need to consider to what extent (if any) the requirements and the related 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 basis for such conclusions to avoid any unintended consequences.
- 16 The IASB staff is of the view that diversity in application described in paragraph 12(c)(ii) is not due to unclear requirements.

- 17 IFRS 9 has clear definitions for the gross carrying amount of a financial asset and for credit loss. For instance, credit loss is defined as the difference between all contractual cash flows that are due to an entity in accordance with the contract and all the cash flows that the entity expects to receive (i.e. all cash shortfalls). It therefore follows that when contractual cash flows are modified, ECL is based on the modified cash flows, not on the original ones. Consequently, an entity cannot avoid remeasuring the gross carrying amount of a financial asset following a modification, as this would be inconsistent with the definitions in IFRS 9 for gross carrying amount and for credit loss.
- 18 The IASB staff acknowledge, however, that the presentation of the gains or losses in this scenario might appear counterintuitive as the accounting outcome might be a release on the ECL allowance (i.e. a gain in the impairment line item in profit or loss) and a modification loss in a different line item.

Other comments

- 19 Only some outreach participants provided additional comments.
- 20 Specifically, these participants noted the need to clarify the boundaries between modification, derecognition (including write-off), and impairment. They identified various scenarios where application challenges arise due to insufficient guidance on these concepts (for example, applying **the concept of ‘extinguishment’ to assess derecognition of lease liabilities**).
- 21 Additionally, participants highlighted the importance of clarifying the **sequence of applying requirements when multiple sets of requirements are applicable** (for example, whether an entity should first revise the ECL of a financial instrument before performing the ‘ten per cent test’ or vice versa).
- 22 Some preparers noted that they generally do not apply the requirements for **partial derecognition** because of their complexity. They asked the IASB clarify when to apply those requirements and the interaction with the other requirements in IFRS 9.

The IASB June discussion

- 23 The IASB discussed the feedback analysis at its June 2025 meeting and generally agreed with the IASB staff analysis.
- 24 Some members expected that Topic 3 have more potential for changes than some other topics. It was noted that care should be taken not to create an unnecessary disruption when providing guidance.
- 25 Members also suggested to involve users further in the process to ensure that potentially proposed changes are noticeable and useful for them.

EFrag FIWG meeting on 9 September 2025

- 26 Some members stated that they apply modification accounting only when there are changes to contractual terms.
- 27 One member noted they currently treat the changes in the interest rates not triggered by contractual terms but resulting from changes in legislation or other similar reasons (e.g. COVID-19) as modifications and suggested that the IASB issues clarifications to confirm this practice.
- 28 Similar to the feedback received by the IASB, several members stated that they apply different rules for derecognition and modification of performing and non-performing loans. They try to avoid the derecognition of the non-performing loans in order not to recognise a new loan as performing in Stage 1 and because POCI accounting is operationally complex.

They suggested that when credit quality of a borrower has deteriorated, a restructuring of a loan should not lead to recognising a new loan in Stage 1. It was suggested that this topic should be addressed by the IASB in this project

The EFRAG Secretariat assessment

- 29 The EFRAG Secretariat notes the important outreach work conducted by the IASB staff and generally agrees with the IASB staff analysis. The feedback confirms and elaborates issues reported by EFRAG on both PIRs of IFRS 9, in particular on interaction of modification, impairment and derecognition and the calculation of EIR for modified financial assets.
- 30 The EFRAG Secretariat reiterates that amortised cost should remain a simple measurement method² and any potential clarifications should be carefully assessed against cost-benefit balance and whether and to what extent it affects the established practice.

Questions to EFRAG FR TEG

- 31 Do you have any comments on the IASB staff feedback analysis of the feedback received on the modification of financial instruments and other topics?

² If and when applied to more complex financial instruments a conceptual pure solution cannot be achieved without making the amortised cost a complex measurement method.