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IFRS Developments

IASB issues amendments to classification and measurement of financial instruments

What you need to know

- The IASB (International Accounting Standards Board) issued amendments to IFRS 9 classification and measurement requirements and IFRS 7 disclosures.
- The amendments clarify that a financial liability is derecognised on the 'settlement date' and introduce an accounting policy choice to derecognise financial liabilities settled using an electronic payment system before the settlement date.
- The classification of financial assets with ESG linked features has been clarified via additional guidance on the assessment of contingent features.
- Clarifications have been made on non-recourse loans and contractually linked instruments.
- Additional disclosures are introduced for financial instruments with contingent features and equity instruments classified at fair value through OCI.
- The amendments are effective for annual periods starting on or after 1 January 2026. Early adoption is permitted, with an option to early adopt the amendments for contingent features only.

Introduction

On 30 May 2024, the International Accounting Standards Board (the IASB or the Board) issued *Amendments to IFRS 9 and IFRS 7, Amendments to the Classification and Measurement of Financial Instruments*. The amendments:

- Clarify that a financial liability is derecognised on the 'settlement date', i.e., when the related obligation is discharged or cancelled or expires or the liability otherwise qualifies for derecognition. They also introduce an accounting policy option to derecognise financial liabilities that are settled through an electronic payment system before settlement date if certain conditions are met.
- Clarify how to assess the contractual cash flow characteristics of financial assets that include environmental, social and governance (ESG)-linked features and other similar contingent features.
- Clarify the treatment of non-recourse assets and contractually linked instruments (CLI).
- Require additional disclosures in IFRS 7 for financial assets and liabilities with contractual terms that reference a contingent event (including those that are ESG-linked), and equity instruments classified at fair value through other comprehensive income (FVTOCI).

The publication of the amendments concludes the classification and measurement phase of the IASB's post implementation review (PIR) of IFRS 9. The other two phases of the PIR of IFRS 9 relate to expected credit losses (ECL), which is in progress, and hedge accounting, which is expected to commence later in 2024.

How we see it

The clarifications that relate to the derecognition of financial liabilities may require entities' existing practice to change. The effect could be significant for their external reporting and accounting processes.

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Date of initial recognition or derecognition of financial assets and financial liabilities

Background

In September 2021, the IFRS Interpretations Committee (IFRS IC) was asked when a financial asset settled by a cash payment received via an electronic transfer system is derecognised. The discussion was extended to the derecognition of a financial liability settled by a payment made through an electronic transfer system.

The IFRS IC identified diversity in practice for the timing of derecognition of financial assets and financial liabilities, not just those settled via an electronic transfer system, but also using other methods. This includes settlement by cheque, debit card and credit card. The issue was sufficiently material to require a change to IFRS 9 and was, therefore, brought into the scope of the IFRS 9 PIR.

Derecognition requirements for financial liabilities

The resulting amendments comprise two elements.

- Clarification that a financial liability is derecognised on the settlement date, which is the date on which the liability is extinguished because the obligation specified in the contract is discharged or cancelled or expires or the liability otherwise qualifies for derecognition.[1]
- For a financial liability settled, in full or in part, in cash using an electronic payment system, an entity is permitted to make an accounting policy election to derecognise the liability before settlement date, if certain conditions are met.[2]

The amendments respond to the practice identified by the IFRS IC in some jurisdictions, whereby entities adjust cash balances at the reporting period end to reflect cash payments and receipts in-transit[3]. This affects the timing for the recognition and derecognition of the corresponding financial liabilities and financial assets. However, the accounting election introduced only applies to the derecognition of financial liabilities. Derecognition of a financial asset remains based on the expiry of the right to receive cash.

Electronic payment system

The amendments address the specific scenario of payments made using an electronic payment system for financial liabilities. They do not apply to any other means of paying financial liabilities, such as payments by cheque, debit card or credit card. The conditions for a financial liability (or a part of a financial liability) to be derecognised before settlement date are, as follows:

- The entity has no practical ability to withdraw, stop or cancel the payment instruction.
- The entity has no practical ability to access the cash to be used for settlement as a result of the payment instruction; and
- The settlement risk associated with the electronic payment system is insignificant. For this to be the case, the payment system must have both of the following characteristics:
  - Completion of the instruction follows a standard administrative process
  - There is only a short time between the entity i) ceasing to have the practical ability to withdraw, stop or cancel the instruction and to access the cash, and ii) when the cash is delivered to the counterparty

Settlement risk would not be insignificant if completion of the payment instruction were subject to the entity's ability to deliver cash on the settlement date.

Entities that make this accounting policy election to derecognise the financial liability before settlement date, must apply this treatment to all financial liabilities settled using the same electronic payment system.

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[1] Amendments to the Classification and Measurement of Financial Instruments, May 2024, paragraph B3.1.2A page 6.
[2] Ibid, paragraph B3.3.8, page 6.
[3] For example, a cheque written to settle a financial liability but not cleared at the reporting date is deducted from the cash balance and the corresponding liability is derecognised.

How we see it

Entities must review the electronic payment systems they use to understand when in the payment process the conditions for derecognition are met and whether to apply the accounting policy election. This may require significant work for entities operating in multiple jurisdictions with cross-border payments.

Assessing the contractual cash flow characteristics for the classification of financial assets

Financial assets with ESG-linked features [4]

The accounting treatment for financial assets for which the interest rate varies depending on the achievement of ESG targets was identified as a high priority to be addressed in the PIR. The IASB decided not to develop guidance specific to ESG-linked financial instruments because to do so would diverge from the principle-based approach of IFRS 9, including the 'solely payment of principal and interest on the principal amount outstanding' (SPPI) assessment.

The IASB has made two broad amendments. The first clarifies the assessment of whether the lender's compensation is consistent with a basic lending arrangement:

- The focus is on *what* the lender is compensated for rather than *how much*
- Nonetheless, the amount of compensation may indicate that the lender is being compensated for something other than basic lending risks and costs
- Contractual cash flows are inconsistent with a basic lending arrangement if they are indexed to a variable that is not a basic lending risk or cost (for example, the value of equity instruments, the price of a commodity) or if they represent a share of the debtor's revenue or profit, even if such terms are common in the market

The second amendment covers how contractual terms that change the timing or amount of contractual cash flows should be assessed, considering:

- Whether the contractual cash flows that could arise both before and after the change would meet the SPPI requirements, irrespective of the probability of the contingent event occurring
- Whether the nature of the contingent event relates directly to, and the contractual cash flows change in the same direction as, changes in basic lending risks and costs

The amendments explain that when the nature of the contingent event does not relate directly to changes in basic lending risks and costs, the SPPI requirements may still be met. This is provided that the contingent feature gives rise to contractual cash flows that are consistent with a basic lending arrangement both before and after the change and that are not *significantly different* from the cash flows for an identical financial asset without such a contingent feature.

The amendments include two examples to illustrate this approach.

How we see it

Entities will need to consider all scenarios in which the contractual cash flows could possibly change and apply judgement to assess whether contractual cash flows arising from a contingent feature are 'significantly different' to an identical financial asset without such a feature.

Financial assets with non-recourse features[5]

The amendments clarify that, for a financial asset to have non-recourse features, the creditor's contractual right to receive cash flows must be limited to the cash flows generated by specified assets, i.e., the entity is exposed to the specified assets' performance risk not the debtor's credit risk. If a creditor has a contractual right to require a debtor to 'top-up' pledged assets, the creditor has recourse to the debtor.

If a financial asset has non-recourse features, a 'look-through' assessment of the link between the particular underlying assets or cash flows and the contractual cash flow is required. How this link is affected by other contractual arrangements, such as subordinated debt or equity instruments issued by the debtor shall be considered.

[4] Ibid, paragraph B4.1.8A page 8, B4.1.10A page 8, B4.1.14 page 10
[5] Ibid, paragraph B4.1.16A page 11 and B4.1.17A page 11

Contractually linked instruments[6]

Contractually linked instruments (CLI) can arise in non-recourse structures where issuers create concentrations of credit risk through tranches of debt. The amendments clarify that:

- CLI must feature a waterfall payment structure that creates concentration of credit risk by allocating losses disproportionately between different tranches.
- CLIs are not created where multiple debt instruments of differing seniority are issued to facilitate lending to a single creditor holding the junior tranche.
- The underlying pool can include financial instruments not in the scope of IFRS 9 classification and measurement (e.g., lease receivables), but must have cash flows that are equivalent to SPPI (e.g., not subject to residual value risk nor indexed to a market rental rate).

Amendments to IFRS 7 *Financial Instruments: Disclosures*[7]

For investments in equity instruments designated at FVTOCI, the amendments add a disclosure requirement for the change in fair value during the period, to show separately amounts relating to investments derecognised in the period and those held at period-end for each class of investment. Also, the aggregate fair value of investments for each class of investment will need to be disclosed as well as any transfer of cumulative gains and losses within equity for instruments derecognised during the reporting period.

For contingent events that do not relate directly to changes in basic lending risks and costs, the amendments introduce new disclosures to help users better understand the effects of terms that could change the timing or amount of contractual cash flows. They apply to financial instruments with ESG-linked features and to all other financial assets at amortised cost, or FVTOCI and financial liabilities at amortised cost, with contingent features, in particular:

- A qualitative description of the nature of the contingent event
- Quantitative information about the possible changes to contractual cash flows, e.g., a range
- The gross carrying amount of financial assets and the amortised cost of financial liabilities subject to the contingent features

How we see it

Obtaining the quantitative and qualitative data needed for the disclosures for contingent features may require significant effort. Entities will need to assess the appropriate level of qualitative and quantitative disclosure to provide.

Transition and effective date

The date of mandatory initial application is periods beginning on or after 1 January 2026. Entities can early adopt the amendments that relate to the classification of financial assets plus the related disclosures and apply the other amendments later.

The new requirements will be applied retrospectively with an adjustment to opening retained earnings. Prior periods are not required to be restated and can only be restated without using hindsight. An entity is required to disclose information about financial assets that change their measurement category due to the amendments.

How we see it

Even though some of the amendments represent clarifications to existing IFRS, since they have required the IASB to make changes to IFRS 9, they only become applicable from their effective date.

In deciding whether to early adopt the amendments, entities will need to consider the timing for when the amendments will be endorsed for use in their jurisdiction.

[6] Ibid, paragraph B4.1.20 page 11, B4.1.20A, B4.1.21 and B4.1.23 page 12.
[7] Ibid, paragraph 11A page 13 and 20B page 14, 20C and 44LL, page 18.

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