DIGITAL CFO SOLUTIONS • IFRS SERIES

ACTIVE STANDARD

INTERNATIONAL FINANCIAL REPORTING STANDARDS

IAS 32 · IFRS 9 · IFRS 7

Financial Instruments

Classification, recognition, measurement, impairment, hedge accounting and disclosure — updated for the 2024 Classification & Measurement amendments and IFRS 18

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ROADMAP

What We Will Cover

Foundations & Definitions

What makes a contract a financial instrument, asset or liability

Derivatives & Compound Instruments

Derivatives, embedded derivatives, and splitting debt from equity

Classification (IFRS 9)

The business model and SPPI tests that drive every classification outcome

Recognition & Measurement

Initial and subsequent measurement, transaction costs, and gains and losses

Expected Credit Losses

The forward-looking impairment model that replaced incurred-loss accounting

Reclassification & Derecognition

When assets move between categories, and when they leave the balance sheet

Hedge Accounting

Fair value hedges, cash flow hedges, and hedges of a net investment

Presentation & Disclosure

Offsetting, and what IFRS 7 requires about risk and fair value

PART I — FOUNDATIONS

What Is a Financial Instrument?

IAS 32 defines the building blocks — financial instrument, financial asset, financial liability and equity instrument — that IFRS 9 and IFRS 7 build on.

FOUNDATIONS

The Definition of a Financial Instrument

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

- ✦ The definition is deliberately contract-based: it is the CONTRACTUAL relationship between two or more parties that creates a financial instrument — not the underlying economic substance alone.
- ✦ A contract need not be in writing, but it must give rise to enforceable rights and obligations between at least two parties.
- ✦ IAS 32 provides the definitions; IFRS 9 governs classification, recognition and measurement; and IFRS 7 governs disclosure — the three Standards operate as a single integrated framework for financial instruments.

FOUNDATIONS

Financial Assets — The Definition

A financial asset is any asset that is one of the following.

1 Cash

The most basic financial asset — currency held by the entity.

2 An equity instrument of another entity

A residual interest in the assets of another entity after deducting all of its liabilities.

3 A contractual right to receive cash or another financial asset

From another entity — e.g. a trade receivable or a loan asset.

4 A contractual right to exchange instruments on potentially favourable terms

A right to exchange financial assets or liabilities with another entity under conditions that are potentially favourable to the holder.

5 A contract settled in the entity's own equity instruments

Either a derivative that will or may be settled other than by exchanging a fixed amount of cash for a fixed number of the entity's own equity instruments, or a non-derivative for which the entity may receive a variable number of its own equity instruments.

FOUNDATIONS

Financial Liabilities — The Definition

A financial liability is any liability that is one of the following.

1 A contractual obligation to deliver cash or another financial asset

To another entity — e.g. a trade payable or a loan liability.

2 A contractual obligation to exchange instruments on potentially unfavourable terms

An obligation to exchange financial assets or liabilities with another entity under conditions that are potentially unfavourable to the entity.

3 A contract settled in the entity's own equity instruments

Either a derivative that will or may be settled other than by exchanging a fixed amount of cash for a fixed number of the entity's own equity instruments, or a non-derivative for which the entity may be obliged to deliver a variable number of its own equity instruments.

Examples — What IS and Is NOT a Financial Instrument

Item	Category	Why
Cash & bank balances, trade receivables	Financial asset	Meets the definition directly
Investment in equity shares	Financial asset	An equity instrument of another entity
Loans & bonds payable, trade payables, bank overdraft	Financial liability	A contractual obligation to deliver cash
Non-convertible redeemable preference shares	Financial liability	A contractual obligation to redeem for cash
Inventories, property, plant & equipment	NOT a financial instrument	A physical resource, not a contractual right to cash
Prepaid expenses	NOT a financial instrument	A right to receive a service, not cash or another financial asset
Intangible assets	NOT a financial instrument	An identifiable non-monetary resource without physical substance
Income tax assets & liabilities	NOT a financial instrument	A statutory right or obligation, not a contractual one

PART II — DERIVATIVES

Derivatives & Embedded Derivatives

A derivative is a financial instrument whose value changes with an underlying variable, requires little or no initial investment, and settles at a future date.

What Is a Derivative?

A derivative is a financial instrument with all three of the following characteristics.

Value Changes with an Underlying

Its value changes in response to a change in a specified interest rate, financial instrument price, commodity price, exchange rate, index or similar variable — its 'underlying'.

No or Low Initial Investment

It requires no initial net investment, or an initial net investment that is smaller than would be required for other contract types with a similar response to market changes.

Settled at a Future Date

It is settled at a future date — creating a contractual right or obligation whose value moves with the underlying, favourably or unfavourably.

Common Types of Derivatives

Type	Description	Typical Underlying
Forwards	Over-the-counter contracts to buy or sell a specific quantity of an instrument, with delivery or settlement on a pre-agreed future date	Currency, commodity, equity price
Futures	Exchange-traded contracts, economically similar to forwards but standardised and margined daily	Currency, commodity, equity price
Options	Contracts giving the purchaser the right, but not the obligation, to buy or sell a specified quantity of an instrument	Interest rate, equity price, currency
Swaps	Contracts to exchange cash flows on specified dates, based on a notional amount	Interest rate, currency rate, commodity price, credit rating

Embedded Derivatives

An embedded derivative is a component of a hybrid contract that also includes a non-derivative host, causing some of the cash flows of the combined instrument to vary in a way similar to a stand-alone derivative.

- A derivative that is attached to a financial instrument, but is contractually transferable independently of that instrument, or has a different counterparty, is NOT an embedded derivative — it is a separate financial instrument.
- Under IFRS 9, if the host contract is a financial asset within IFRS 9's scope, the ENTIRE hybrid contract is classified and measured as a whole — applying the business model and SPPI tests — with no separate accounting for the embedded derivative.
- Where the host is a financial liability or a non-financial-asset host, the embedded derivative may still require separate ("bifurcated") accounting if it is not closely related to the host and the combined contract is not otherwise measured at fair value through profit or loss.

PART III — DEBT VS EQUITY

Debt vs Equity & Compound Instruments

IAS 32 requires the ISSUER of a financial instrument to classify it as a financial liability, an equity instrument, or a compound instrument containing both elements, based on its substance.

The Classification Test

An instrument is classified as a financial LIABILITY (rather than equity) from the issuer's perspective if it contains a contractual obligation of either kind below.

- ✦ An obligation to deliver cash or another financial asset to another party — e.g. a redeemable bond, or a preference share the issuer must redeem at a fixed or determinable future date.
- ✦ An obligation to exchange financial assets or financial liabilities with the holder under conditions that are potentially UNFAVOURABLE to the issuer.
- ✦ If NEITHER obligation exists — for example, ordinary shares with no redemption obligation and fully discretionary dividends — the instrument is classified as EQUITY.
- ✦ The classification looks to the SUBSTANCE of the contractual arrangement, not merely its legal form — a preference share legally labelled 'equity' may still be a financial liability in substance.

Compound Financial Instruments

Compound financial instruments are hybrid instruments that combine both a debt element and an equity element — the classic example is a convertible bond.

- ✦ The debt element is the obligation to pay coupon interest and, typically, to repay principal — e.g. a 5% five-year convertible debenture.
- ✦ The equity element is the holder's option to convert into a fixed number of the issuer's own equity shares — a fixed-for-fixed conversion feature.
- ✦ IAS 32 requires the issuer to SPLIT the proceeds: the liability component is measured first, at the fair value of a similar bond with no conversion feature; the equity component is the RESIDUAL — total proceeds minus the liability component.
- ✦ The equity component is never subsequently remeasured — it is recognised once, at issuance, and stays in equity until conversion or expiry.
- ✦ See Illustration III for a full worked split of a convertible bond into its liability and equity components.

PART IV — CLASSIFICATION

Classification of Financial Instruments

IFRS 9 classification for financial assets turns on two tests applied together — an entity's business model, and the contractual cash flow characteristics of the asset.

Classification of Financial Assets — Two Tests

Both tests must be considered together to determine how a financial asset is classified and subsequently measured.

Business Model Test

- How does the entity manage this GROUP of financial assets to generate cash flows — by collecting contractual cash flows, by both collecting and selling, or primarily through sale?
- Assessed at a portfolio level, based on how key management personnel actually manage the business — not on management's stated intentions for a single instrument.
- Business models are typically observable through actual sales activity, how performance is evaluated and reported, and how risks are managed.

Contractual Cash Flow (SPPI) Test

- Do the contractual terms give rise, on specified dates, to cash flows that are SOLELY PAYMENTS OF PRINCIPAL AND INTEREST (SPPI) on the principal amount outstanding?
- 'Interest' compensates for the time value of money, credit risk, other basic lending risks and costs, and a profit margin — nothing more exotic.
- Contractual terms that introduce exposure to risks or volatility unrelated to a basic lending arrangement — e.g. exposure to equity prices — fail the SPPI test.

An asset passes into Amortised Cost or FVOCI only if it passes SPPI — failing SPPI sends any instrument straight to FVTPL, regardless of the business model.

The Three Classification Categories for Financial Assets

Amortised Cost

Business model: hold to collect contractual cash flows, AND the asset passes SPPI. Typical example: a term loan held for collection, or trade receivables.

Fair Value Through OCI (FVOCI)

Business model: hold to collect AND sell, AND the asset passes SPPI. Interest, impairment and FX go to profit or loss; other fair value movements go to OCI, recycled on derecognition.

Fair Value Through Profit or Loss (FVTPL)

The default category — applies whenever an asset fails SPPI, or the business model is neither of the above (e.g. actively traded). All fair value movements go to profit or loss.

CLASSIFICATION

Classification & Measurement of Financial Liabilities

Financial liabilities have a simpler default classification than financial assets.

- ✦ ALL financial liabilities are subsequently measured at AMORTISED COST using the effective interest method, EXCEPT for the specific categories below.
- ✦ Financial liabilities at fair value through profit or loss — including derivative liabilities — measured at fair value, with movements in profit or loss (subject to the own-credit-risk rule below).
- ✦ Financial liabilities arising from a transfer of a financial asset that does not qualify for derecognition, financial guarantee contracts, below-market loan commitments, and contingent consideration in a business combination (IFRS 3) — each with its own specified measurement basis.
- ✦ The FVTPL option: an entity may irrevocably designate a financial liability at FVTPL at initial recognition if doing so eliminates or significantly reduces an accounting mismatch, or if the liability is part of a group managed and evaluated on a fair value basis under a documented risk management strategy reported to key management personnel.
- ✦ For a liability designated at FVTPL, the change in fair value attributable to the entity's OWN credit risk is presented in OCI, not profit or loss — unless doing so would create or enlarge an accounting mismatch.

PART V — RECOGNITION & MEASUREMENT

Recognition & Measurement

From the moment an entity becomes party to a contract, through initial and subsequent measurement, to where gains and losses ultimately land.

Initial Recognition, Initial Measurement & Transaction Costs

- Initial recognition: an entity recognises a financial asset or financial liability in its statement of financial position when, and only when, it becomes party to the contractual provisions of the instrument.
- A regular-way purchase or sale of financial assets is recognised and derecognised using either trade date accounting or settlement date accounting, applied consistently.
- Initial measurement: all financial instruments are initially measured at FAIR VALUE, plus or minus — for an instrument not measured at FVTPL — directly attributable TRANSACTION COSTS.
- Transaction costs are incremental costs directly attributable to the acquisition, issue or disposal of a financial instrument — e.g. registration and regulatory fees, and fees paid to legal, accounting and other professional advisers — but exclude debt premiums or discounts, financing costs and internal administrative costs.
- Transaction costs attributable to an equity transaction that would otherwise have been avoided are deducted from equity, net of any related tax benefit.

Subsequent Measurement — Summary

Instrument & Classification	Measured At	Value Changes	Impairment?
Debt instrument — Amortised Cost	Amortised cost (effective interest method)	Not applicable, unless impaired	Yes — ECL model
Debt instrument — FVOCI	Fair value	Through OCI (interest, FX & impairment through P&L)	Yes — ECL model
Debt instrument — FVTPL	Fair value	Through profit or loss	No — already at FV
Equity instrument — FVOCI election (irrevocable)	Fair value	Through OCI, never recycled to P&L	No
Equity instrument — FVTPL (default)	Fair value	Through profit or loss	No
Financial liability — Amortised Cost (default)	Amortised cost (effective interest method)	Not applicable, unless modified	No
Financial liability — FVTPL (designated)	Fair value	P&L, except own credit risk to OCI	No

Measurement of Derivatives & Embedded Derivatives

- All derivatives — including those linked to unquoted equity investments — are measured at fair value, both on initial recognition and subsequently.
- Fair value changes are recognised in profit or loss, UNLESS the entity has designated the derivative as a hedging instrument in a qualifying hedge relationship, in which case the hedge accounting requirements of IFRS 9 apply instead.
- For a hybrid financial ASSET, no separate accounting for an embedded derivative is performed — the whole instrument is classified using the business model and SPPI tests.
- For a hybrid contract with a non-financial-asset host (or a financial liability host), an embedded derivative not closely related to the host, in a contract not otherwise measured at FVTPL, is separated and measured at fair value through profit or loss.

RECOGNITION & MEASUREMENT

Gains and Losses — Where Do They Go?

A gain or loss on a financial asset or financial liability measured at fair value is recognised in PROFIT OR LOSS, unless one of the exceptions below applies.

1 Part of a hedging relationship

Hedge accounting under IFRS 9 changes the normal timing and location of recognition — see Part VIII.

2 An equity investment with the FVOCI election

Gains and losses on an equity instrument the entity has irrevocably elected to present at FVOCI go to OCI and are NEVER recycled to profit or loss.

3 A financial liability designated at FVTPL, own credit risk

The change attributable to changes in the liability's own credit risk is presented in OCI, unless that would create an accounting mismatch.

4 A debt instrument measured at FVOCI

Fair value movements go to OCI (except interest, FX gains/losses and impairment, which still go to profit or loss), and ARE recycled to profit or loss on derecognition.

PART VI — IMPAIRMENT

Expected Credit Losses

IFRS 9 replaced IAS 39's incurred-loss model with a forward-looking expected credit loss (ECL) model — one of the most significant changes financial reporting has seen in the last decade.

The General Three-Stage Approach

The general approach applies a loss allowance that depends on how much credit risk has changed since initial recognition.

Stage 1 — Performing

No significant increase in credit risk since initial recognition. Loss allowance = 12-month expected credit losses. Interest is recognised on the GROSS carrying amount.

Stage 2 — Underperforming

A significant increase in credit risk since initial recognition, but not yet credit-impaired. Loss allowance = LIFETIME expected credit losses. Interest still on the gross carrying amount.

Stage 3 — Credit-Impaired

Objective evidence of impairment exists (e.g. significant financial difficulty, default, or a breach of contract). Loss allowance = lifetime ECL. Interest is now recognised on the NET carrying amount (amortised cost less allowance).

The Simplified Approach & Measuring ECL

Simplified Approach

- For trade receivables and contract assets without a significant financing component, an entity is REQUIRED to always recognise a loss allowance at an amount equal to LIFETIME expected credit losses — no staging assessment is needed.
- For trade receivables and contract assets WITH a significant financing component, and for lease receivables, this simplified approach is an accounting POLICY CHOICE, applied consistently.
- In practice, a PROVISION MATRIX — grouping receivables by shared credit risk characteristics such as ageing — is a common practical expedient (see Illustration II).

Measuring Expected Credit Losses

- Expected credit losses are a PROBABILITY-WEIGHTED estimate of credit losses, incorporating the probability of default (PD), loss given default (LGD), and exposure at default (EAD).
- The estimate reflects reasonable and supportable information about past events, current conditions, and forecasts of future economic conditions — available without undue cost or effort.
- Expected credit losses are discounted to present value at the effective interest rate (or an approximation of it) determined at initial recognition.

PART VII — RECLASSIFICATION & DERECOGNITION

Reclassification & Derecognition

When financial assets move between classification categories, and the conditions under which financial assets and liabilities leave the balance sheet.

Reclassification of Financial Assets & Liabilities

Reclassification of a financial asset is required only when an entity CHANGES ITS BUSINESS MODEL for managing that group of financial assets — a rare event — and is applied prospectively from the reclassification date, with no restatement of prior gains, losses or interest.

Reclassification Direction	Accounting at the Reclassification Date
Amortised Cost → FVTPL	Measured at fair value; the difference from the previous amortised cost is recognised in PROFIT OR LOSS.
FVTPL → Amortised Cost	Fair value at the reclassification date becomes the new gross carrying amount.
Amortised Cost → FVOCI	Measured at fair value; the difference from the previous amortised cost is recognised in OTHER COMPREHENSIVE INCOME.
FVOCI → Amortised Cost	Reclassified at fair value, but the cumulative OCI gain/loss is removed from equity and adjusted against the fair value — as if always measured at amortised cost. No effect on profit or loss.
FVTPL ↔ FVOCI	The asset continues to be measured at fair value in both directions; moving out of FVOCI reclassifies the cumulative OCI balance to profit or loss.
Financial liabilities	An entity shall NOT reclassify any financial liability — ever.

Derecognition of Financial Assets

An entity derecognises a financial asset when, and only when, its contractual rights to the cash flows expire, or it transfers the asset and the transfer qualifies for derecognition.

- A transfer occurs when an entity transfers the contractual rights to receive the cash flows, or retains those rights but assumes a contractual obligation to pass the cash flows to another party under a qualifying "pass-through" arrangement.
- The key test is an evaluation of RISKS AND REWARDS: if the entity transfers substantially all risks and rewards, it derecognises the asset; if it retains substantially all risks and rewards, it continues to recognise the asset in full.
- Where neither is the case, the entity assesses whether it has retained CONTROL: if not, it derecognises the asset; if control is retained, it continues to recognise the asset to the extent of its continuing involvement.
- On full derecognition, the difference between the carrying amount and the consideration received (including any new asset obtained, less any new liability assumed) is recognised in profit or loss.

Derecognition of Financial Liabilities

A financial liability is removed from the statement of financial position when, and only when, it is EXTINGUISHED — the obligation is discharged, cancelled, or expires.

- ✦ An exchange between an existing borrower and lender of debt instruments with SUBSTANTIALLY DIFFERENT terms, or a SUBSTANTIAL MODIFICATION of the terms of an existing liability, is accounted for as an extinguishment of the original liability and recognition of a new one.
- ✦ The difference between the carrying amount of the liability extinguished (or transferred) and the consideration paid — including any non-cash assets transferred or liabilities assumed — is recognised in profit or loss.
- ✦ See the 2024 amendment on electronic payment settlement in Part XI, which clarifies the derecognition DATE for liabilities settled through an electronic payment system.

PART VIII — HEDGE ACCOUNTING

Hedge Accounting

A technique that changes the normal basis for recognising gains and losses, so that a hedging instrument and its hedged item are recognised in profit or loss in the same period.

Key Concepts & Qualifying Criteria

Key Concepts

- Hedged item: an asset, liability, firm commitment, forecast transaction, or net investment in a foreign operation that exposes the entity to risk of changes in fair value or future cash flows, and is specifically designated for hedge accounting.
- A forecast transaction designated as a hedged item must be HIGHLY PROBABLE.
- Hedging instrument: a designated derivative (or, in limited cases, a non-derivative financial asset or liability for foreign currency risk) whose fair value or cash flows are expected to offset changes in the hedged item.

Qualifying Criteria

- An ECONOMIC RELATIONSHIP exists between the hedged item and the hedging instrument, such that their values generally move in offsetting directions because of the same underlying risk.
- The effect of credit risk does not DOMINATE the value changes that result from that economic relationship.
- The hedge ratio of the hedging relationship is the same as that used for the actual quantities of the hedged item and hedging instrument the entity actually uses — no artificial weighting to manufacture ineffectiveness or over-effectiveness.

IFRS 9 relaxed IAS 39’s bright-line 80–125% effectiveness test in favour of this more principles-based, risk-management-aligned assessment.

The Three Types of Hedge

Fair Value Hedge

The hedging instrument is remeasured at fair value through profit or loss (or OCI, for certain equity instruments). The hedged item's carrying amount is adjusted for the hedged risk, also through profit or loss.

Cash Flow Hedge

The effective portion of the gain or loss on the hedging instrument is recognised in OCI (the cash flow hedge reserve), limited to the lower of the cumulative change on the instrument and on the hedged item. The ineffective portion goes to profit or loss.

Net Investment Hedge

A hedge of a net investment in a foreign operation is accounted for like a cash flow hedge: the effective portion to OCI (alongside the translation reserve), the ineffective portion to profit or loss.

PART IX — PRESENTATION & DISCLOSURE

Presentation & Disclosure

IAS 32 governs presentation — including offsetting — while IFRS 7 requires disclosures that let users evaluate the significance of financial instruments and the risks they create.

Offsetting Financial Assets & Liabilities

A financial asset and a financial liability are offset, and the NET amount presented, only when BOTH conditions below are met.

- ✦ The entity currently has a LEGALLY ENFORCEABLE right to set off the recognised amounts — enforceable both in the normal course of business and in the event of default, insolvency or bankruptcy.
- ✦ The entity intends either to settle on a net basis, or to realise the asset and settle the liability SIMULTANEOUSLY.
- ✦ A master netting arrangement that creates a right of set-off enforceable only on default, insolvency or bankruptcy does NOT, by itself, justify offsetting in the ordinary course of business — the underlying gross assets and liabilities are presented gross, with the arrangement disclosed under IFRS 7.

DISCLOSURE (IFRS 7)

Disclosure — Statement of Financial Position & Fair Value

1 Carrying amounts by classification category

Financial assets at amortised cost, at FVOCI (further split between debt and equity instruments), and at FVTPL (split between mandatory and designated).

2 Financial liabilities by classification

At amortised cost and at FVTPL (split between held-for-trading and designated), each with the reasons for FVTPL designation where applicable.

3 Reclassifications

Where an entity has reclassified financial assets during the period, the date, reasons, and the amount reclassified into and out of each category.

4 Fair value information

The fair value of each class of financial asset and liability, in a way that permits comparison with its carrying amount, together with the fair value hierarchy level and valuation techniques used.

Disclosure — Income Statement, Equity & Accounting Policies

- Net gains or losses by classification category — amortised cost, FVOCI (debt and equity split) and FVTPL (mandatory and designated split) — presented separately.
- Total interest income and interest expense for financial instruments not measured at FVTPL, calculated using the effective interest method.
- Fee income and expense arising from financial instruments not measured at FVTPL, and from trust and fiduciary activities.
- Impairment losses on financial assets by class, including a reconciliation of the loss allowance account and interest income recognised on credit-impaired financial assets.
- The accounting policies and methods adopted, including the criteria applied in determining classification and the basis for measuring expected credit losses.

Disclosure — Hedge Accounting

- A description of each hedging relationship, the hedging instrument used and its fair value, and the nature of the risks being hedged, together with the entity's risk management strategy.
- For cash flow hedges: the periods in which the hedged cash flows are expected to occur and affect profit or loss, and a description of any forecast transaction previously hedged that is no longer expected to occur.
- For amounts recognised in OCI on a cash flow hedge: the amount recognised in the period, the amount reclassified to profit or loss, and any amount removed from OCI and included in the initial cost of a non-financial asset or liability.
- For fair value hedges: fair value changes of the hedging instrument and of the hedged item attributable to the hedged risk.
- Hedge ineffectiveness recognised in profit or loss, disclosed separately for cash flow hedges and net investment hedges.

DISCLOSURE (IFRS 7)

Nature & Extent of Risk Exposure

For each type of risk arising from financial instruments, an entity discloses both qualitative and quantitative information.

Credit Risk

Maximum exposure before collateral, a description of collateral held, credit quality of assets neither past due nor impaired, and analysis of assets that are past due or credit-impaired.

Liquidity Risk

A maturity analysis of financial liabilities showing remaining contractual maturities, and a description of how the entity manages the liquidity risk inherent in that maturity profile.

Market Risk

The risk that fair value or cash flows will fluctuate due to changes in market prices — covering interest rate risk, currency risk and other price risk, typically via sensitivity analysis.

PART X — APPLICATION

Worked Illustrations

Four institutional-grade examples covering classification, expected credit losses, a compound instrument split, and fair value hedge accounting.

Illustration I — Business Model & SPPI Classification

FACT PATTERN

An entity holds two debt portfolios. Portfolio A consists of fixed-rate corporate bonds with standard principal and interest terms; the entity's business model is to collect contractual cash flows through to maturity, and it rarely sells. Portfolio B consists of similar bonds, but the entity actively buys and sells within the portfolio to manage liquidity, with both collecting cash flows and selling being integral to achieving the portfolio's objective. Required: classify both portfolios under IFRS 9.

SOLUTION

Both portfolios pass the SPPI test: the contractual cash flows are solely payments of principal and interest on the principal amount outstanding, with no equity-linked or other exotic features.

Portfolio A's business model is to hold assets to collect contractual cash flows, with sales being incidental rather than integral — combined with a SPPI pass, this portfolio is classified and measured at AMORTISED COST.

Portfolio B's business model achieves its objective through BOTH collecting contractual cash flows AND selling financial assets — combined with a SPPI pass, this portfolio is classified and measured at FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME (FVOCI).

If Portfolio B instead held equity-linked notes whose returns depended on an equity index, both portfolios would fail SPPI and be classified at FVTPL regardless of the business model.

Illustration II — Expected Credit Losses (Provision Matrix)

FACT PATTERN

A retailer has $1,000,000 of trade receivables at the reporting date, with no significant financing component, so it applies the simplified approach using a provision matrix based on ageing and historical loss rates, adjusted for forward-looking information.

SOLUTION — provision matrix:

Ageing	Gross Receivable ($)	ECL Rate	Loss Allowance ($)
Not yet due	600,000	0.5%	3,000
1–30 days past due	250,000	2%	5,000
31–60 days past due	90,000	10%	9,000
61–90 days past due	40,000	30%	12,000
Over 90 days past due	20,000	75%	15,000
Total	**1,000,000**	**—**	**44,000**

The retailer recognises a loss allowance of $44,000 against gross trade receivables of $1,000,000, presenting net receivables of $956,000. Because trade receivables use the simplified approach, there is no staging assessment — lifetime expected credit losses apply to the entire balance from initial recognition.

Illustration III — Compound Instrument (Convertible Bond)

FACT PATTERN

An entity issues a 5-year convertible bond for cash proceeds of $10,000,000, carrying a 4% annual coupon, convertible at the holder's option into a fixed number of ordinary shares. A similar bond with no conversion feature would have required an 8% coupon. Required: split the proceeds into their liability and equity components.

SOLUTION — the liability component is measured first, at the present value of the coupon and principal cash flows discounted at 8% (the market rate for an equivalent non-convertible bond); the equity component is the residual:

Component	Basis	Amount ($)
Liability component	PV of $400,000 coupon for 5 years + $10,000,000 principal, discounted at 8%	**9,202,000 (approx.)**
Equity component (residual)	Total proceeds $10,000,000 – liability component	**798,000 (approx.)**
Total proceeds	—	**10,000,000**

The $9,202,000 liability component is subsequently measured at amortised cost using the effective interest method at 8%, accreting up towards $10,000,000 at redemption (if not converted). The $798,000 equity component is recognised once, in equity, and is never subsequently remeasured.

Illustration IV — Fair Value Hedge

FACT PATTERN

On 1 January 20X1, an entity holds a fixed-rate bond investment (the hedged item) with a carrying amount of $5,000,000, classified at amortised cost. The entity enters an interest rate swap (the hedging instrument, fair value $0 at inception) to hedge the bond's exposure to fair value changes from interest rate movements, in a qualifying fair value hedge relationship. By 31 December 20X1, the swap's fair value has increased to an asset of $120,000, and the bond's fair value (attributable to the hedged interest rate risk) has decreased by $118,000. Required: show the year-end accounting.

SOLUTION

The hedging instrument (the swap) is remeasured to fair value, with the gain recognised in profit or loss: Dr Swap asset $120,000 / Cr Profit or loss $120,000.

The hedged item's carrying amount is adjusted for the change in fair value attributable to the hedged risk, also through profit or loss: Dr Profit or loss $118,000 / Cr Bond carrying amount $118,000 — even though the bond is otherwise held at amortised cost.

Net effect in profit or loss for the year: a $2,000 net gain ($120,000 gain on the swap less $118,000 loss on the hedged item) — this SMALL net amount is the hedge ineffectiveness, the whole purpose of fair value hedge accounting being to largely offset the two movements.

Without hedge accounting, the swap's $120,000 gain would hit profit or loss on its own, with no corresponding adjustment to the amortised-cost bond — creating an artificial mismatch that fair value hedge accounting is designed to eliminate.

PART XI — RECENT DEVELOPMENTS

Recent Developments

The 2024 Classification & Measurement amendments to IFRS 9 and IFRS 7, and how IFRS 18 reshapes the presentation of financial instrument income and expense.

RECENT DEVELOPMENTS

The 2024 Classification & Measurement Amendments

Amendments to the Classification and Measurement of Financial Instruments (Amendments to IFRS 9 and IFRS 7), issued 30 May 2024, effective for annual periods beginning on or after 1 January 2026 (early application permitted).

- Derecognition of financial liabilities settled by electronic payment: an entity may now elect, as an accounting policy, to derecognise a financial liability BEFORE the settlement date, if it uses an electronic payment system that meets specified criteria — irrevocable payment instruction, no practical ability to withdraw or amend it, and insignificant settlement risk.
- Clarified SPPI assessment for contingent features: contractual cash flows remain SPPI-consistent if a contingent event is SPECIFIC to the debtor (e.g. a change directly related to basic lending risks and costs), regardless of how likely the event is to occur — this directly addresses ESG-linked loan features (e.g. sustainability-linked interest rate ratchets).
- New guidance on "non-recourse" financial assets (where the claim is limited to specified assets or cash flows) and "contractually linked instruments" (tranched structures such as securitisations) — clarifying what the SPPI assessment requires "looking through" to.

New Disclosures from the 2024 Amendments

1 Equity instruments designated at FVOCI

Disaggregated disclosure by nature and purpose of the investment, plus the fair value and cumulative gain or loss at derecognition, and where that cumulative amount was transferred within equity.

2 Contingent contractual features

For financial assets and liabilities with contractual terms that could change cash flows based on a contingent event not directly related to basic lending risks (e.g. ESG-linked terms) — the nature of the feature and how it could affect cash flows.

3 Electronic payment derecognition policy

Where an entity applies the new derecognition policy for liabilities settled by electronic payment, disclosure of that policy and the carrying amount of liabilities to which it was applied.

4 Effective date & transition

Effective for annual periods beginning on or after 1 January 2026; early application is permitted, with specific transition reliefs available for the SPPI reassessment on adoption.

RECENT DEVELOPMENTS

Impact of IFRS 18 on Financial Instrument Presentation

IFRS 18 Presentation and Disclosure in Financial Statements replaces IAS 1 and is effective for annual periods beginning on or after 1 January 2027 (early application permitted).

Financing Category — the Default Home

Interest expense on borrowings, and (for most entities) interest income and dividend income on investments, are classified in the newly-defined FINANCING category, rather than being freely positioned as before.

Operating Classification for Financial Entities

Entities whose main business activity is investing in financial assets, or providing financing to customers (e.g. banks, insurers), classify related interest and fair value movements in the OPERATING category instead.

What Does NOT Change

IFRS 18 does not alter how financial instruments are classified, measured, or how gains and losses are recognised under IFRS 9 — the impact is on which income statement category each line lands in, and new required subtotals.

SUMMARY

Key Takeaways

Three Standards, one framework

IAS 32 defines, IFRS 9 classifies and measures, IFRS 7 discloses — they operate together as a single system.

Two tests drive every asset classification

The business model test and the SPPI test, applied together, determine amortised cost, FVOCI or FVTPL.

ECL is forward-looking, not backward-looking

The three-stage general approach and the simplified approach for receivables both look ahead, not just at incurred losses.

Hedge accounting realigns timing

Fair value, cash flow and net investment hedges each change WHEN and WHERE a gain or loss is recognised, not the total amount.

2026 brings sharper SPPI guidance

The 2024 amendments clarify ESG-linked features, non-recourse assets, contractually linked instruments, and electronic payment derecognition.

IFRS 18 reshapes presentation, not measurement

Interest, dividends and fair value movements move into defined operating or financing categories from 2027 — the accounting underneath is unchanged.

A Career Built on Making IFRS Understandable

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ABOUT THE AUTHOR

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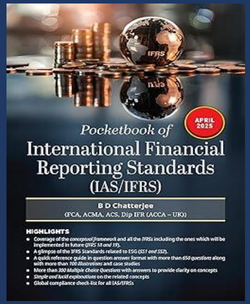

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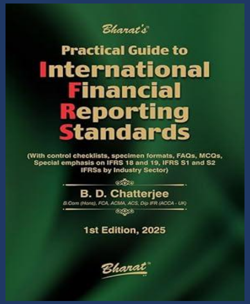

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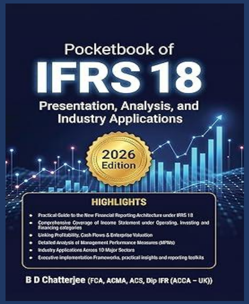

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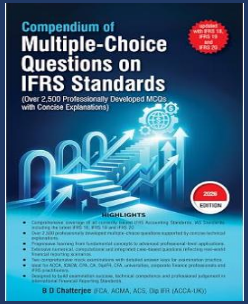

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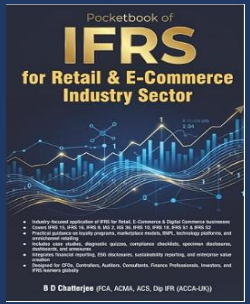

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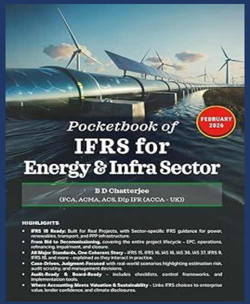

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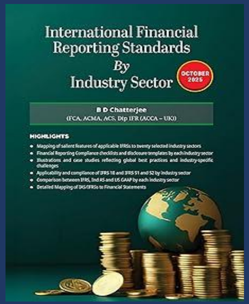

International Financial Reporting Standards by Industry Sector

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