

A photograph of two lighthouses on a rocky island. The lighthouse on the right is taller and white with a green top. The one on the left is shorter and white with a red top. They are situated on a rocky outcrop in the middle of a blue sea.

# HKFRS/IFRS UPDATE 2024/07

November 2024

## Amendments to HKFRS/IFRS 9 and HKFRS/IFRS 7 - Amendments to the Classification and Measurement of Financial Instruments

### Background

In 2022, the International Accounting Standards Board (IASB) carried out a post-implementation review (PIR) of the classification and measurement requirements in IFRS 9 *Financial Instruments* and related requirements in IFRS 7 *Financial Instruments: Disclosures*. After analysing the feedback, the IASB concluded that, in general, entities are able to apply the classification and measurement requirements of IFRS 9 consistently; however, clarification was needed on certain matters to improve the understandability of the requirements.

In September 2021, the IFRS Interpretations Committee (the Committee) issued a Tentative Agenda Decision (TAD) that addressed a request received about the recognition of cash received via an electronic transfer system as settlement for a financial asset. Some concerns were raised about the possible implications of the TAD, primarily on settlement of financial liabilities. Acknowledging these concerns, the IASB decided to propose amendments to the requirements in IFRS 9.

In March 2023, the IASB proposed narrow-scope amendments to IFRS 9 and IFRS 7 that address the above two matters ie areas requiring clarification, as identified from the feedback to the PIR, and concerns raised on the TAD on the recognition of cash received via an electronic transfer system as settlement for a financial asset.

After analysing the feedback to the Exposure Draft and further deliberations, on 30 May 2024, the IASB issued *Amendments to the Classification and Measurement of Financial Instruments – Amendments to IFRS 9 and IFRS 7* (the Amendments). The HKICPA published the equivalent amendments to HKFRS 9 and HKFRS 7 on 8 August 2024. The Amendments and other related documents may be accessed on the [project page](#) on the IFRS Foundation website.

### Status

Final

### Effective date

1 January 2026

### Accounting impact

The Amendments clarify

- the requirements related to the date of recognition and derecognition of financial assets and financial liabilities, with an exception for derecognition of financial liabilities settled via an electronic transfer.
- the requirements for assessing contractual cash flow characteristics of financial assets, with additional guidance on assessment of contingent features.
- characteristics of non-recourse loans and contractually linked instruments.

The Amendments also introduce additional disclosure requirements for equity instruments classified as FVOCI and for financial instruments with contingent features.

The Amendments address the following areas:

| AMENDMENTS RELATED TO: |   |
|------------------------|---|
| 1                      | Derecognition of financial liabilities settled through electronic transfers                   |
| 2                      | Classification of financial assets  |
|                        | Elements of interest in a basic lending arrangement   |
|                        | Contractual terms that change the timing or amount of contractual cash flows                  |
|                        | Financial assets with non-recourse features   |
|                        | Investments in contractually linked instruments   |
| 3                      | Disclosures   |
|                        | Investments in equity instruments designated at fair value through other comprehensive income |
|                        | Contractual terms that could change the timing or amount of contractual cash flows            |

Primarily to address financial assets with environmental, social and governance (ESG)-linked features.

## Derecognition of financial liabilities

### What is the issue?

In 2021, the IFRS Interpretations Committee (the Committee) received a request about the recognition of cash received via an electronic transfer system as settlement for a financial asset.

The fact pattern in the request described an electronic transfer system that has an automated settlement process that takes three working days to settle a cash transfer. All cash transfers made via the system are therefore settled (deposited in the recipient's bank account) two working days after they are initiated by the payer. An entity has a trade receivable with a customer. At the entity's reporting date, the customer has initiated a cash transfer via the electronic transfer system to settle the trade receivable. The entity receives the cash in its bank account two days after its reporting date. The question raised was whether the entity can derecognise the trade receivable and recognise cash on the date the cash transfer is initiated (its reporting date), rather than on the date the cash transfer is settled (after its reporting date).

The Committee concluded in its TAD that, applying IFRS 9, an entity:

- derecognises a trade receivable on the date when its contractual rights to the cash flows from the trade receivable expire; and
- recognises the cash (or other financial asset) received as settlement of that trade receivable on the same date.

Although most respondents to the TAD agreed with or did not disagree with the technical analysis in the TAD, a number of concerns were raised on other implications of the TAD, especially in the context of settlement of financial liabilities such as trade payables.

The main concerns raised included the following:

- Unintended possible consequences for other fact patterns such as accounting for settlement of trade payables and risk of inconsistent application to fact patterns beyond the one considered in the request.
- Disruption to long-standing accounting practices such as performing bank reconciliations and accounting for cheques when written or received.
- Changes in approach as a consequence of the agenda decision being costly and complex to apply due to required changes to systems, processes and internal controls and possible legal analysis required to determine when rights to cash flows expire.

Given these concerns, the IASB decided to propose amendments to the requirements of IFRS 9 before considering whether to finalise the agenda decision.

## What do the Amendments require?

Prior to the Amendments, HKFRS/IFRS 9 did not explicitly specify whether an entity is required to apply trade date accounting or settlement date accounting when recognising or derecognising a financial asset or a financial liability, except for regular way purchase or sale of assets. In the Exposure Draft, the IASB had proposed to clarify that entities are required to apply settlement date accounting when recognising or derecognising a financial asset or a financial liability. However, to avoid the risk

of unintended consequences for the initial recognition and derecognition of financial assets, in the final Amendments, the IASB decided to refer to 'settlement date' only in the context of the derecognition of financial liabilities.

The Amendments add paragraph B3.1.2A to HKFRS/IFRS 9 that introduces the requirements related to the date of initial recognition or derecognition for financial assets and financial liabilities.

The following table summarises the requirements:

|  | Financial assets   |  | Financial liabilities   |  |
|--|--|--|---|--|
|  |  |  | Other than those being settled with cash using an electronic payment system | Liabilities being settled with cash using an electronic payment system   |
| <b>Recognition (except for regular way purchase or sale)</b> | On the date on which the entity becomes party to the contractual provisions of the instrument    |  |   |  |
| <b>Derecognition</b>   | On the date on which the contractual rights to the cash flows expire or the asset is transferred |  | Settlement date (*)   | Option to deem to be discharged before the settlement date if the specific criteria are met (HKFRS/IFRS 9.B3.3.8) (**) |

(\*) 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

(\*\*) to be applied to all settlements made through the same electronic payment system.

Thus, all financial assets and liabilities are required to be recognised on the date on which the entity becomes party to the contractual provisions of the instrument.

A financial asset is required to be derecognised on the date on which the contractual rights to the cash flows expire or the asset is transferred.

Financial liabilities, other than those to be settled in cash using an electronic payment system, are required to be derecognised on the settlement date.

### Derecognition of financial liabilities to be settled in cash using an electronic payment system:

For a financial liability (or part of a financial liability) settled in cash using an electronic payment system, the Amendments permit an entity to deem the financial liability (or part of it) to be discharged before the settlement date. This option is available if, and only if, the entity has initiated a payment instruction that resulted in:

- the entity having no practical ability to withdraw, stop or cancel the payment instruction;
- the entity having 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 being insignificant.

If an entity elects to apply this option, it is required to apply it to all settlements made through the same electronic payment system.

### What is meant by insignificant settlement risk?

The Amendments clarify that settlement risk associated with an electronic payment system is insignificant if:

- the completion of the payment instruction follows a standard administrative process; and
- the time between (i) and (ii) below is short:
  - the entity ceasing to have the practical ability to withdraw, stop or cancel the payment instruction and to access the cash to be used for settlement as a result of the payment instruction (ie the point in time when criteria (a) and (b) specified above are met); and
  - the cash being delivered to the counterparty.

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

Corresponding credit entry when a financial liability is derecognised applying HKFRS/IFRS 9.B3.3.8:

As noted by the IASB in the Basis for Conclusions to the Amendments (BC3.61), by deeming the liability to be discharged by applying the option in HKFRS/IFRS 9.B3.3.8, an entity also deems its right to the cash used to discharge the liability to be expired once it loses the practical ability to access that cash.

Therefore, the entity would derecognise the corresponding cash when the liability is deemed to be discharged.

Key points to note:

- The accounting policy election to deem a financial liability to be discharged before the settlement date applies **only to financial liabilities** settled in cash using an electronic payment system.
- A similar accounting policy election is **not available for financial assets**.
- This accounting policy election is **not available for other modes of settling financial liabilities** such as **cheques, debit/ credit cards**.

*Why is the proposed amendment restricted to financial liabilities to be settled with cash using an electronic payment system?*

The IASB has noted in the Basis for Conclusions (BC3.55) that electronic payment systems establish a controlled environment for cash transfers so that the risk of the cash not being delivered to the creditor is minimal (or de minimis). The IASB further observes that, for other payment methods, such as cheques, completion of the payment remains subject to settlement risk that is more than insignificant until the cash is delivered (that is, transferred from the payer's account). As a result, the IASB decided not to expand the scope of the requirements beyond electronic payment systems for derecognition of financial liabilities.

Some respondents to the Exposure Draft of the amendments suggested that a similar exception should be extended to derecognition of financial assets. However, the IASB decided against it. The IASB has noted in the Basis for Conclusions to the Amendments (BC3.58-59) that derecognition of a financial asset is based on the expiry of the right to receive cash (or another financial asset) and not the rights or obligations of the counterparty. When a creditor receives notification that a debtor has submitted a payment instruction, the creditor does not get practical ability to access the cash. That happens only when the cash is delivered to the creditor's account. Therefore, the IASB concluded that a debtor meeting the criterion in IFRS

9.B3.3.8 does not justify the derecognition of a financial asset by the creditor before the settlement date.

**Practical implications of the Amendments**

- Entities may need to change their existing accounting practices for derecognition of financial assets such as trade receivable and recognition of cash received via modes of payments such as electronic transfers, cheques or debit/credit cards.
- Entities may also need to change their existing accounting practices for derecognition of financial liabilities such as trade payables and derecognition of cash paid via modes of payment such as cheques, debit/credit cards or electronic transfers that do not meet the specified criteria for applying the exception in HKFRS/IFRS 9.B3.3.8.
- Entities intending to apply the exception in HKFRS/IFRS 9.B3.3.8 to derecognition of financial liabilities need to evaluate the electronic payment systems involved to assess whether they meet the specified criteria. This may involve extensive operational and legal analysis, especially for entities operating in multiple jurisdictions.
- If an entity/a group of entities elects to apply the exception in HKFRS/IFRS 9.B3.3.8, it may lead to inconsistencies in intercompany balances, as the derecognition exception applies to financial liabilities but not to financial assets. Further adjustments to intercompany balances may be required for elimination of intra-group balances in consolidation.

**BDO Comment**

The practical implications of the amendments may be most significant for entities that settle financial liabilities using: (1) cheques; (2) electronic payment systems that do not meet the criteria in HKFRS/IFRS 9.B3.3.8.

For cheques, the amendments indirectly clarify that the payer has not settled the financial liability until the cheque clears, meaning the longstanding accounting practice of deducting outstanding cheques from cash and derecognising the associated financial liability, such as trade payables, will have to be revisited.

For electronic payment systems, certain systems will not meet the criteria in HKFRS/IFRS 9.B3.3.8 when the payment instruction is transmitted. For example, if the payer is able to cancel the instruction within the first 48 hours. Therefore, such payments will not result in the derecognition of the associate financial liability and cash.

## Classification of financial assets – ESG linked features

### Background

Appendix B to HKFRS/IFRS 9 includes application guidance on assessing whether a financial asset's contractual cash flows are solely payments of principal and interest on the principal amount outstanding (SPPI). This assessment is important because if the instrument does not meet this 'SPPI test', then the instrument must be measured at fair value through profit or loss by the holder. Respondents to the PIR observed that it is challenging to apply the SPPI requirements to financial assets with features linked to Environmental, Social and Governance (ESG) factors or other similar features. For example, a bond where the interest rate changes in response to whether the issuer meets carbon emission reduction targets.

The IASB considered this feedback but decided against creating an exception for assets with ESG-linked features. Instead, the IASB has amended IFRS 9 to clarify the general SPPI principles by clarifying the requirements applicable to:

- Elements of interest in a basic lending arrangement; and
- Contractual terms that change the timing or amount of contractual cash flows.

### Elements of interest in a basic lending arrangement

#### What is the issue?

HKFRS/IFRS 9.B4.1.7A states that (emphasis added):

*'Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding are consistent with a basic lending arrangement. In a basic lending arrangement, **consideration for the time value of money and credit risk** are typically the **most significant elements of interest**. However, in such an arrangement, interest can also include consideration for **other basic lending risks** (for example, liquidity risk) and costs (for example, administrative costs) associated with holding the financial asset for a particular period of time. In addition, interest can include **a profit margin** that is consistent with a basic lending arrangement...'*

Applying these requirements to financial assets with ESG-linked features can be challenging. Consider the following example.

Entity A purchases green bonds of Entity B. The bonds carry a coupon of 4% per annum. If Entity B fails to meet a specified reduction in greenhouse gas emissions in a reporting period, the coupon is increased to 5% per annum. The market rate of interest on a similar loan without the ESG-linked feature is 4.1% per annum.

In this case, it is challenging to determine whether the changing interest rate is consistent with a basic lending arrangement ie whether the incremental interest of 1% is consideration for elements of interest in a basic lending arrangement such as for time value of money, credit risk, liquidity risk, etc. or for some other factor.

#### What do the Amendments require?

In order to assist entities assess whether the interest in an arrangement is consistent with a basic lending arrangement, the Amendments have added paragraph B4.1.8A that clarifies that:

- *The assessment of interest focuses on what an entity is being compensated for, rather than how much compensation an entity receives.*

The Basis for Conclusion to HKFRS/IFRS 9 (BC4.182(b)) currently notes that the assessment of interest focuses on what the entity is being compensated for (ie whether the entity is receiving consideration for basic lending risks, costs and a profit margin or is being compensated for something else), instead of how much the entity receives for a particular element. For example, different entities may price the credit risk element differently.

The IASB decided to incorporate this principle into the application guidance.

- *The amount of compensation an entity receives may indicate that the entity 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 or the price of a commodity) or if they represent a share of the debtor's revenue or profit, even if such contractual terms are common in the market in which the entity operates.*

### Contractual terms that change the timing or amount of contractual cash flows

Sometimes a financial asset contains a contractual term that could change the timing or amount of contractual cash flows. For example, a financial asset that can be prepaid before maturity. In such cases, HKFRS/IFRS 9.B4.1.10 requires the entity to determine whether the contractual cash flows that could arise over the life of the instrument due to that contractual term are SPPI. To make this determination, the entity must assess the contractual cash flows that could arise both before, and after, the change in contractual cash flows.

The entity may also need to assess the nature of any contingent event (ie the trigger) that would change the timing or amount of the contractual cash flows. For example, consider a financial instrument with an interest rate that is reset to a higher rate if the debtor misses a particular number of payments. The contractual cash flows for this instrument are more likely to be SPPI than for a financial instrument with an interest rate that reset based on equity index level.

### What is the issue?

- The feedback to the PIR suggested that, from the example in IFRS 9.B4.1.10, entities might infer that, for cash flows to be SPPI, the nature of any contingent event must be associated with one of the elements of interest specified in IFRS 9.B4.1.7A.

IFRS 9.B4.1.10 states that '*while the nature of the contingent event in itself is not a determinative factor in assessing whether the contractual cash flows are solely payments of principal and interest, it may be an indicator*'. However, IFRS 9.B4.1.10 does not provide any requirements or clarifications on when the contractual cash flows may be SPPI if the nature of the contingent event is not related directly to changes in basic lending risks and costs. This assessment is particularly critical in case of instruments with ESG-linked or similar features, where the contractual cash flows change in response to factors that may not be directly related to basic lending risks and costs eg changes in carbon emissions of the issuing entity.

- When developing IFRS 9, some respondents suggested that a contingent feature should not affect the classification and measurement of a financial asset if the likelihood is remote that the future event will occur. However, the IASB rejected this approach. The IASB concluded that an entity is not permitted to take into account the probability that the future event will occur, unless the contingent feature is not genuine (Basis for Conclusions to IFRS 9 – BC186 and BC189). However, this principle was not explicitly

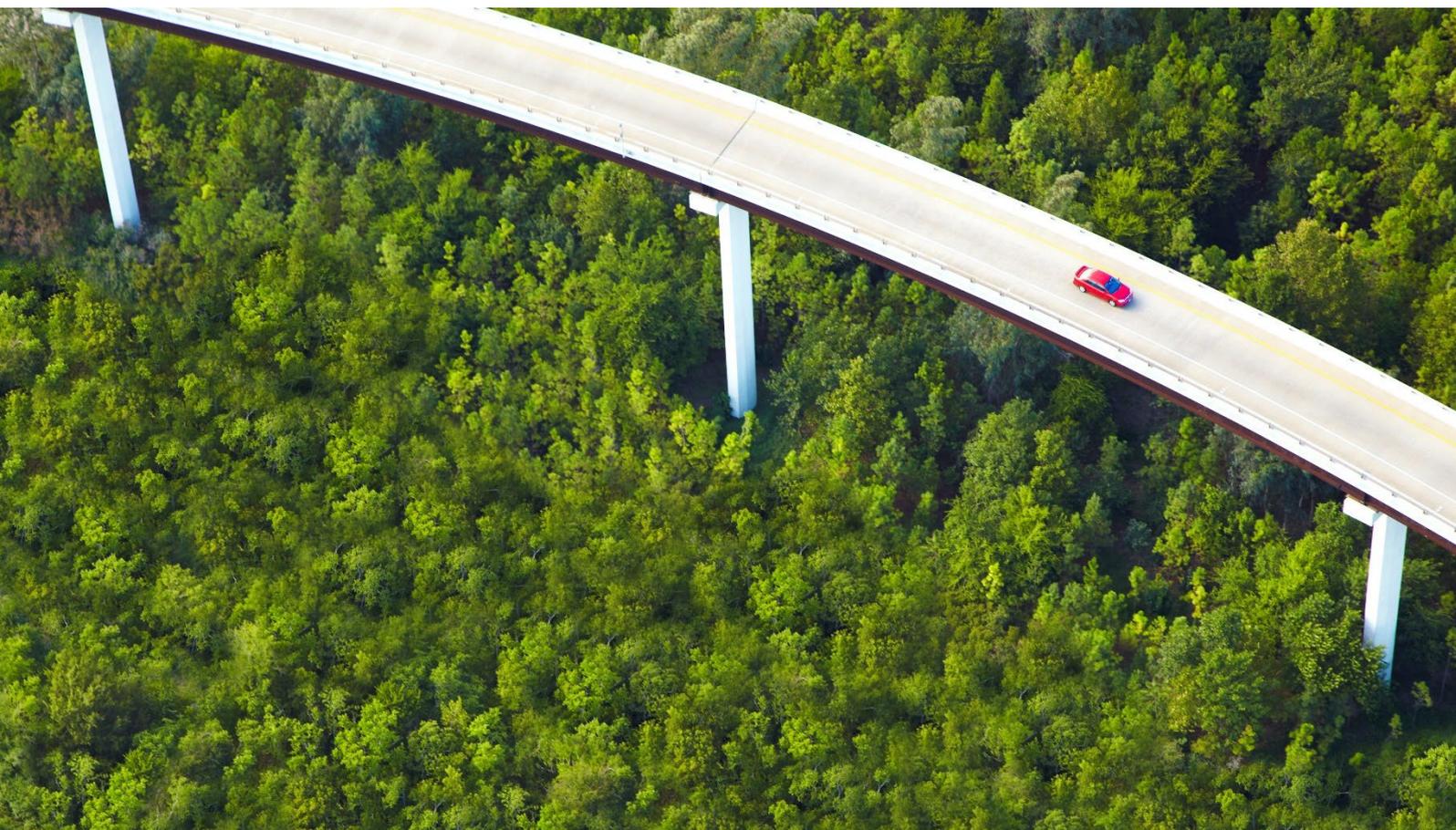
incorporated in IFRS 9.

### What do the Amendments require?

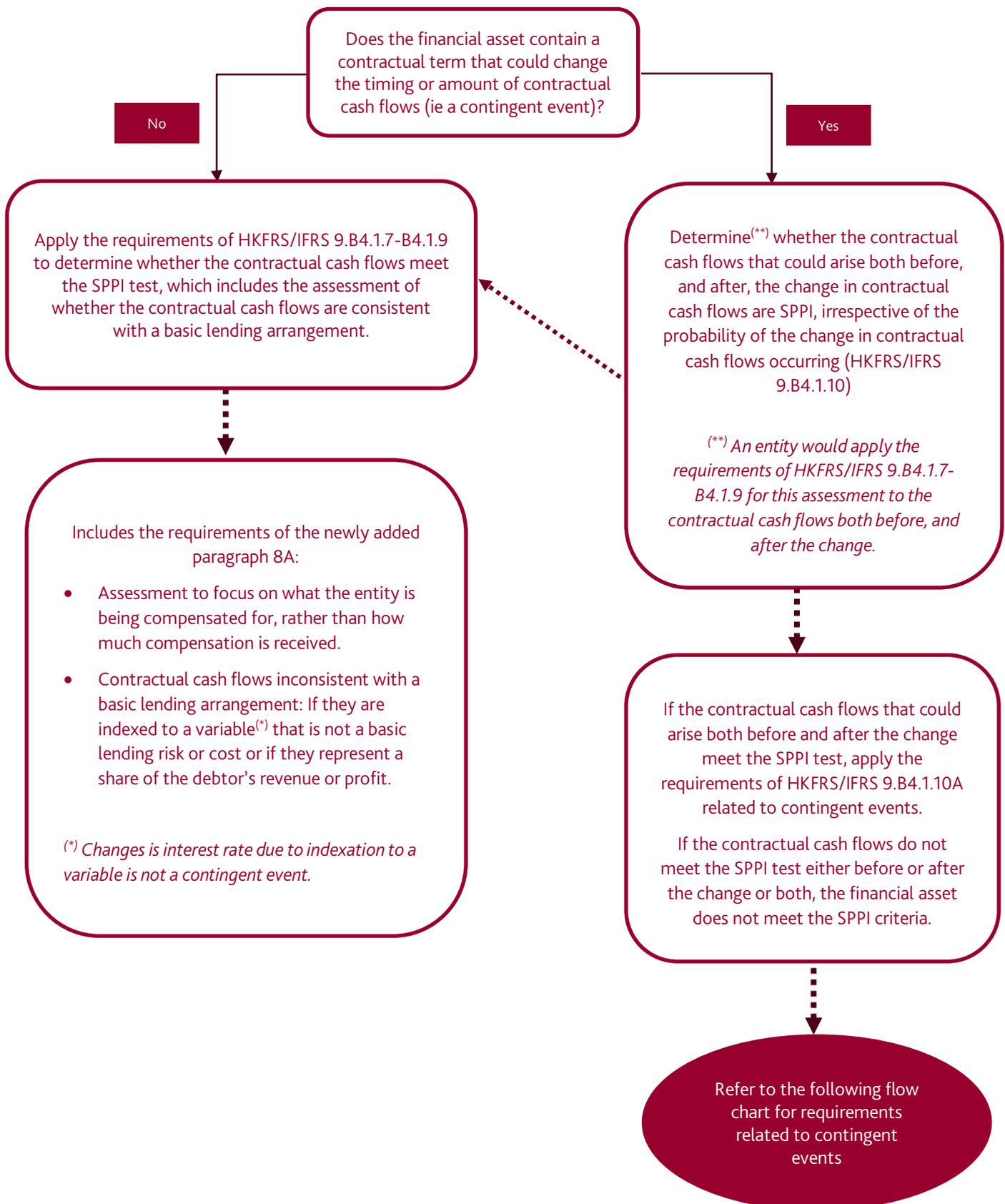
To address the above issues, the IASB has amended paragraph B4.1.10 and added paragraph B4.1.10A. These amendments require the following:

- To determine whether the contractual cash flows that could arise over the life of the instrument are SPPI, the entity is required to assess the contractual cash flows that could arise both before, and after, the change in contractual cash flows, **irrespective of the probability of the change in contractual cash flows occurring** (HKFRS/IFRS 9.B4.1.10).
- If the contingent feature gives rise to contractual cash flows that are consistent with a basic lending arrangement both before and after the change in contractual cash flows, but the nature of the contingent event itself does not relate directly to changes in basic lending risks and costs:
  - The contractual cash flows are SPPI if, and only if, in all contractually possible scenarios, the contractual cash flows would *not be significantly different* from the contractual cash flows on a financial instrument with identical contractual terms, but without such a contingent feature.

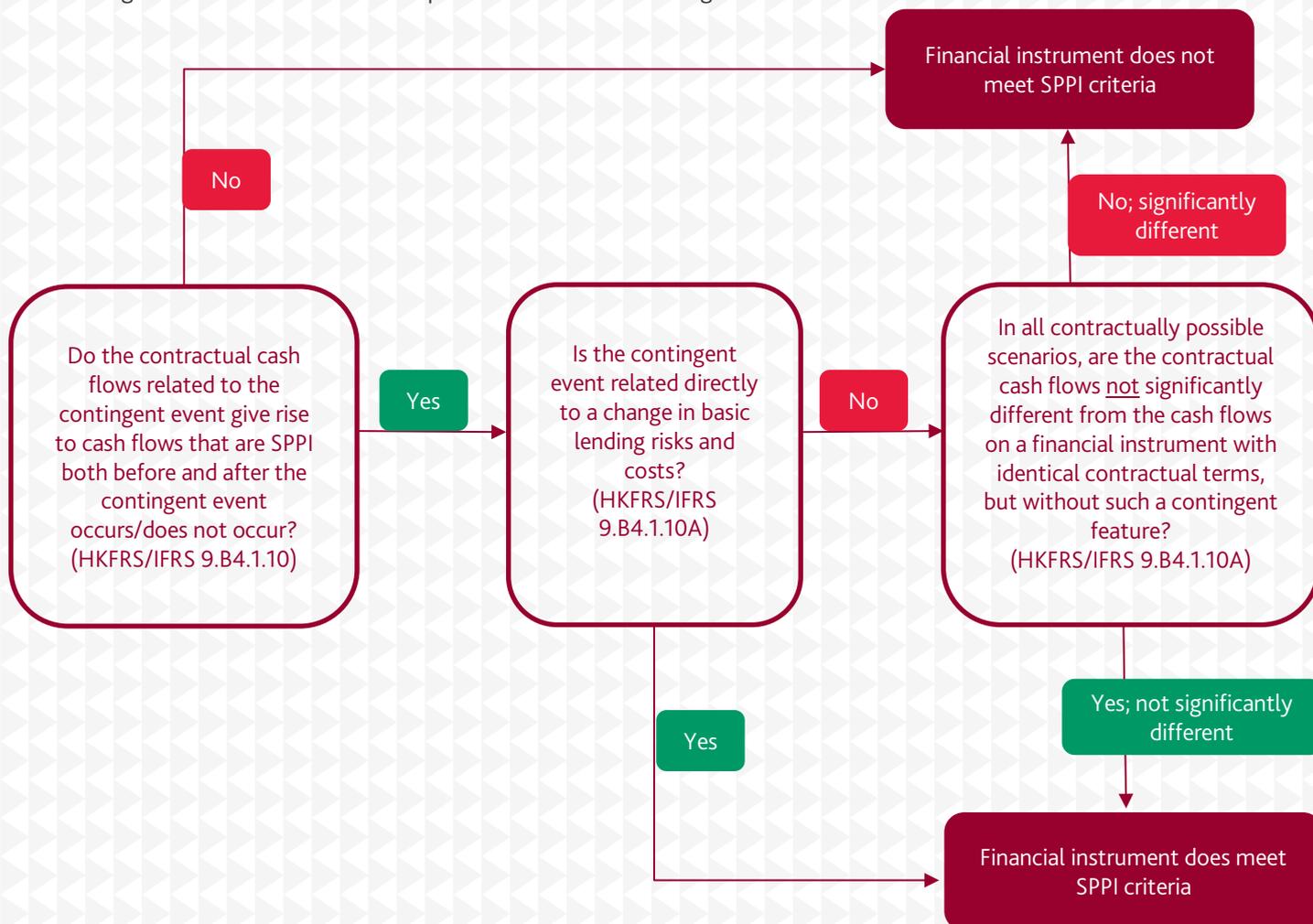
This assessment may be qualitative or quantitative.



The following flow chart summarises the applicability of different paragraphs of HKFRS/IFRS 9 for assessing whether the contractual cash flows meet the SPPI test depending on whether the contractual cash flows change as a result of a contingent event:



The following flow chart summarises the requirements related to contingent events:

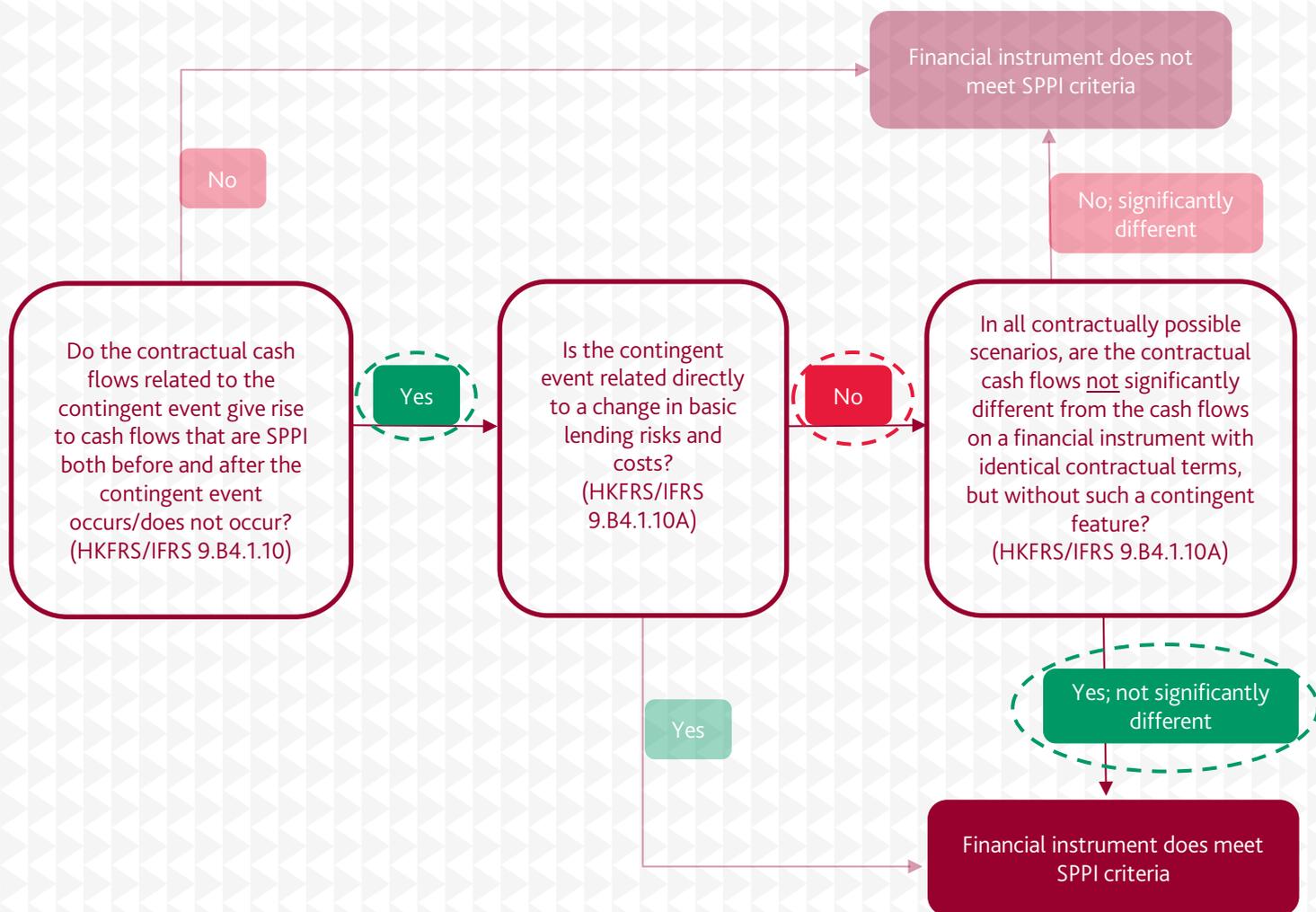


The Amendments include the following two examples to illustrate the application of the requirements:

**Example 1:**

| Instrument  | Analysis  |
|---|---|
| <p>Instrument EA is a loan with an interest rate that is adjusted every reporting period by a fixed number of basis points if the debtor achieves a contractually specified reduction in carbon emissions during the preceding reporting period.</p> <p>The maximum possible cumulative adjustments would not significantly change the interest rate on the loan.</p> | <p>If the contingent event of achieving the carbon emissions target occurs, the interest rate is adjusted by a fixed number of basis points, resulting in contractual cash flows that are consistent with a basic lending arrangement. Only because the nature of the contingent event itself does not relate directly to changes in basic lending risks and costs, the entity needs further assessment to determine whether the cash flows on the financial asset are solely payments of principal and interest.</p> <p>The contractual cash flows would not be significantly different from the contractual cash flows on a financial instrument with identical contractual terms, but without the contingent feature linked to carbon emissions. Any adjustments over the life of the instrument would not result in contractual cash flows that are significantly different, therefore, the loan has contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.</p> |

The analysis of the above instrument using the flow chart is as below:



**Example 2:**

| Instrument   | Analysis   |
|--|--|
| The instrument is a loan with an interest rate that is adjusted every reporting period to track the movements in a market-determined carbon price index during the preceding reporting period. | The contractual cash flows are indexed to a variable (the carbon price index), which is not a basic lending risk or cost. The contractual cash flows are therefore inconsistent with a basic lending arrangement and are not solely payments of principal and interest on the principal amount outstanding. (HKFRS/IFRS 9.B4.1.8A) |

In this example, there is no contingent event the occurrence (or non-occurrence) of which may result in a change in the timing or amount of contractual cash flows. Indexation of interest rate to a market variable is not a contingent event. Therefore, the entity assesses whether the contractual cash flows meet the SPPI test applying the requirements of HKFRS/IFRS 9.B4.1.7-9, including the requirements of the newly added paragraph 8A. The requirements of HKFRS/IFRS 9.B4.1.10-10A do not apply in this case as the instrument does not contain contractual terms that change the timing or amount of contractual cash flows.

## Classification of financial assets – financial assets with non-recourse features

### How do non-recourse features affect the classification of financial assets?

'Non-recourse features' refers to the absence of liability on the part of a debtor beyond specified assets.

For example, a bank provides a loan to Entity A for the construction of a commercial office building. The repayment amounts are limited to the rental income that Entity A earns from letting out the commercial units in the building once it is constructed. In this case, the bank does not have a recourse to other assets of Entity A for the repayment of the loan.

The existence of a non-recourse provision does not in itself preclude a financial asset from meeting the SPPI test. However, non-recourse features may indicate an investment in particular assets or cash flows and therefore, the contractual cash flows may not meet the SPPI test. HKFRS/IFRS 9.B4.1.17 requires the creditor to 'look through to' the particular underlying assets or cash flows to determine whether the contractual cash flows of the financial asset being classified are SPPI.

### What is the issue?

PIR participants asked the IASB to clarify the meaning of the term 'non-recourse' as it is used in IFRS 9.B4.1.16 and, particularly, the difference between financial assets with non-recourse features and financial assets for which a creditor's claim is secured by the assets pledged as collateral.

### What do the Amendments require?

#### BDO Comment

These amendments clarify the difference between a non-recourse loan and a collateralised loan. It appears that for a loan to be considered in accordance with the revised non-recourse requirements in HKFRS/IFRS 9, the limitation of the cash flows that the lender may obtain must be limited based on contractual terms. There may be other situations in which a financial asset represents an investment in particular assets or cash flows when the limitation is not contractual in nature. In that case, entities should consider the requirements of HKFRS/IFRS 9.B4.1.15 – B4.1.16.

The IASB notes in the Basis for Conclusions to the Amendments (BC4.280) that, 'non-recourse features' refers to the absence of liability on the part of a debtor beyond specified assets. In contrast, in the case of a collateralised loan, a creditor's claim is secured by the collateral only in the case of default. Throughout the life of such a collateralised loan, the creditor has recourse to the debtor for repayment of the loan.

The Amendments clarify the following with respect to non-recourse features:

- A financial asset has non-recourse features if an entity's ultimate right to receive cash flows is contractually limited to the cash flows generated by specified assets, ie the entity is primarily exposed to the specified assets' performance risk rather than the debtor's credit risk.
- If a financial asset has non-recourse features, the creditor is required to 'look through' to the link between the particular underlying assets or cash flows and the contractual cash flows of the financial asset being classified. The creditor is required to consider how this link is affected by other contractual arrangements, such as subordinated debt or equity instruments issued by the debtor.

In the Basis for Conclusions to the Amendments (BC4.286), the IASB has noted that, for a financial asset to have non-recourse features, there has to be a contractual, rather than a purely economic, limitation on the creditor's rights to receive contractual cash flows. Such limitation can be established through a combination of contracts, such as in the case of a loan to a structured entity.

## Classification of financial assets – investments in contractually linked instruments

### What is the issue involved?

In certain transactions, an issuer may prioritise payments to the holders of financial assets using multiple contractually linked instruments, known as tranches. In assessing whether investments in such instruments meet the SPPI requirement, HKFRS/IFRS 9 requires an entity to 'look through' until it can identify the underlying pool of financial instruments that are creating (instead of passing through) the cash flows. The entity is then required to assess, among other things, whether this underlying pool contains one or more instruments that have SPPI cash flows.

PIR participants asked the IASB to clarify the scope of the requirements in IFRS 9 related to contractually linked instruments to identify the instruments to which these requirements apply. Participants also asked whether financial instruments that are not entirely within the scope of IFRS 9 could meet the criteria for financial instruments in the underlying pool, as required by IFRS 9.B4.1.23. For example, cash flows arising from leases, which are not in the scope of IFRS 9.

### What do the Amendments require?

#### Scope

The Amendments include the following clarifications on the characteristics of contractually linked instruments (CLI):

- the prioritisation of payments to the holders of these tranches is established through a waterfall payment structure; and
- that payment structure creates concentrations of credit risk and results in a disproportionate allocation of cash shortfalls from the underlying pool between the tranches.

The Amendments also clarify that in the case of CLI transactions, the contractual cash flows are assessed by the holders of a tranche applying the requirements of HKFRS/IFRS 9.B4.1.21-B4.1.26, instead of HKFRS/IFRS 9.B4.1.17.

Lending arrangements to provide enhanced credit protection:

Some lending arrangements are structured to provide enhanced credit protection to a creditor or a group of creditors. The Amendments clarify that the requirements for contractually linked instruments do not apply to such instruments. The contractual cash flows of such debt instruments shall be assessed by applying the requirements in HKFRS/IFRS 9.B4.1.7-B4.1.19.

For example, Entity A has a pool of car loans amounting to CU100 million. In order to obtain funding against the pool of car loans, Entity A agrees to enter into a secured lending arrangement with Entity B. Under the arrangement, Entity A transfers the assets of CU100 million to a Special Purpose Entity (SPE). The SPE issues senior debt instruments of CU80 million to Entity B and junior debt instruments of CU20 million to Entity A. The arrangement restricts Entity A from selling the junior debt instruments unless the senior debt instruments are

repaid. This arrangement may appear to have the characteristics of CLI. But, the purpose of the arrangement is to provide enhanced credit protection to Entity B. Therefore, the contractual cash flows in this arrangement shall be assessed by applying the requirements in HKFRS/IFRS 9.B4.1.7-B4.1.19.

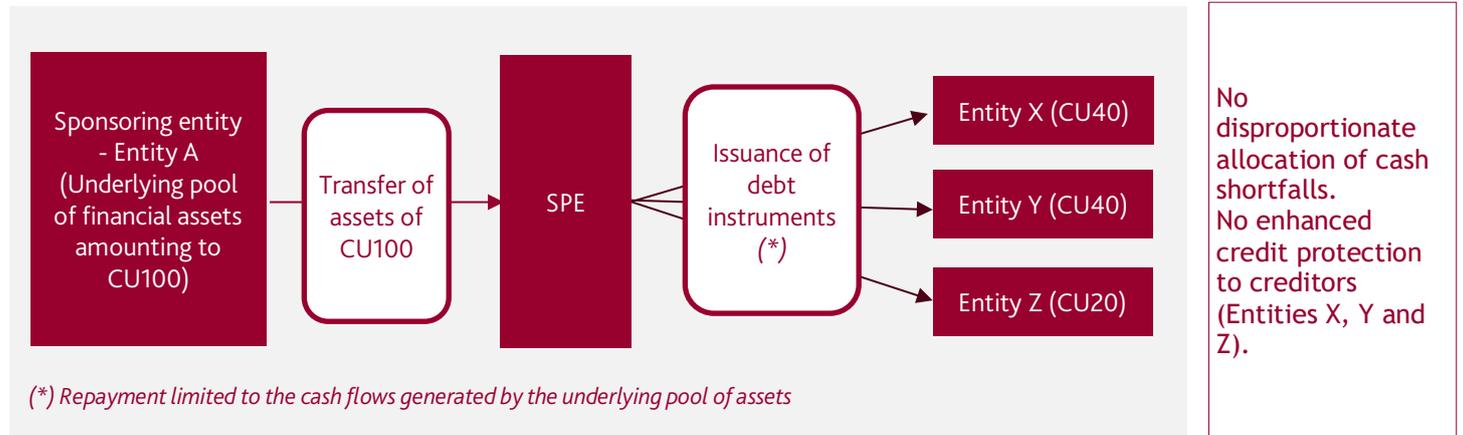
Why is the distinction between instruments with non-recourse features and contractually linked instruments important?

Contractually linked instruments have non-recourse features. However, an important distinction between contractually linked instruments from financial assets with non-recourse features is the disproportionate allocation of cash shortfalls from the underlying pool between the holders of the tranches. HKFRS/IFRS 9 requires the holders of both financial assets with non-recourse features and CLI to 'look through to' the underlying pool of assets to determine whether the underlying pool of assets contains instruments with contractual cash flows that are SPPI. However, for contractually linked instruments, there are additional requirements that must be met for the instrument to meet the SPPI test.



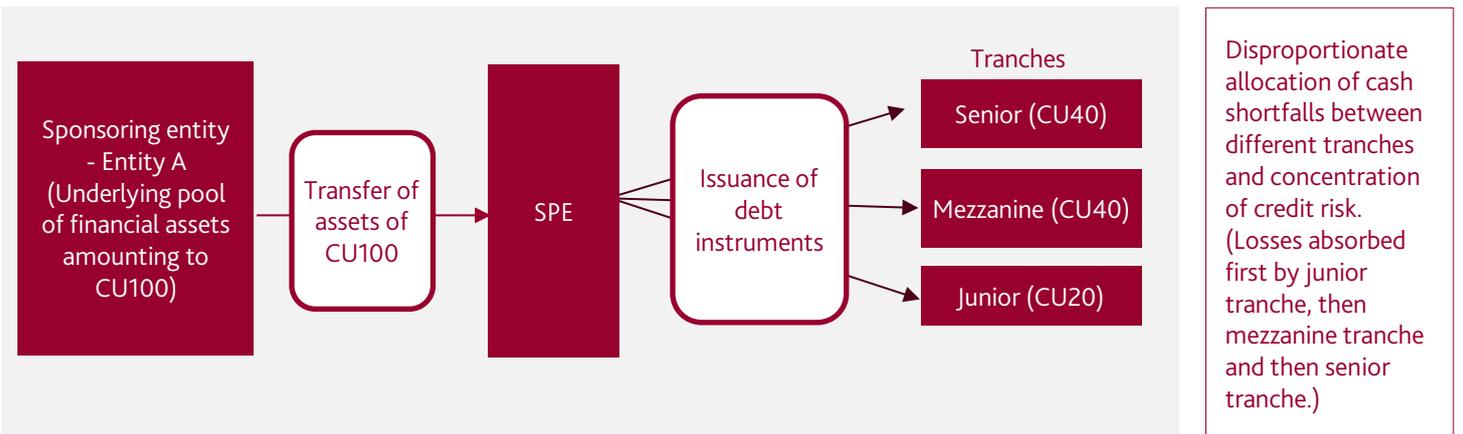
The following diagrams describe arrangements that may be instruments with non-recourse features, CLI or enhanced credit protection:

Arrangement I – Instruments with non-recourse features:



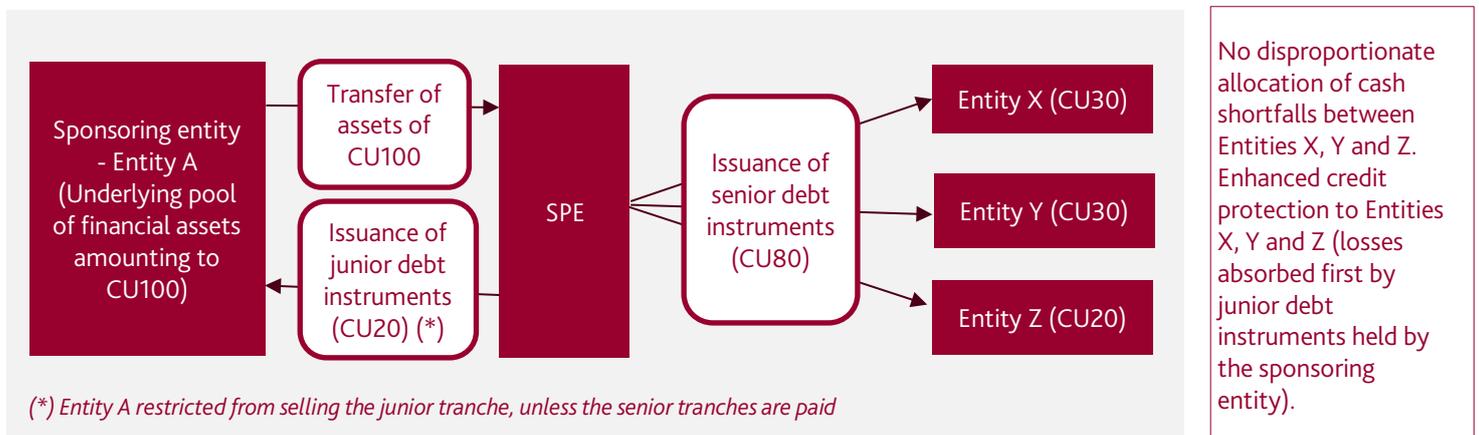
The contractual cash flows for the above arrangement (for debt instruments held) are assessed in accordance with HKFRS/IFRS 9.B4.1.17.

Arrangement II – Contractually linked Instruments:



The contractual cash flows for the above arrangement (for debt instruments held) are assessed in accordance with HKFRS/IFRS 9.B4.1.21-B4.1.26, instead of HKFRS/IFRS 9.B4.1.17.

Arrangement III – Instruments that provide enhanced credit protection to creditors:



The contractual cash flows for the above arrangement (for debt instruments held) are assessed in accordance with HKFRS/IFRS 9.B4.1.17-B4.1.19, instead of HKFRS/IFRS 9.B4.1.21-B4.1.26.

### Composition of the underlying pool of financial instruments:

In response to the feedback from the PIR, the Amendments clarify that financial instruments that are not within the scope of the classification requirements of HKFRS/IFRS 9, such as lease receivables, can be included in the underlying pool of financial instruments provided they have cash flows that are equivalent to SPPI cash flows.

### Disclosures

#### Investments in equity instruments designated at fair value through other comprehensive income (OCI)

When an equity investment designated at fair value through OCI (FVOCI) is disposed of, HKFRS/IFRS 9 prohibits the entity from reclassifying the amounts accumulated in OCI to profit or loss. Some PIR participants noted that this treatment may not faithfully represent the performance of such investments upon disposal.

The IASB noted that neither IFRS 9 nor IFRS 7 distinguishes between 'realised' and 'unrealised' gains or losses, and that it had received no evidence as part of the PIR to support the contention that reclassification of amounts recognised and accumulated in OCI to profit or loss would necessarily result in users of financial statements receiving more or better information about realised gains than they do from existing requirements.

However, in response to the feedback, the IASB has amended IFRS 7 to require entities to disclose the fair value gain or loss on equity investments designated at FVOCI presented in OCI during the period, showing separately:

- the fair value gain or loss related to investments derecognised during the reporting period; and
- the fair value gain or loss related to investments held at the end of the reporting period.

The Amendments have amended HKFRS/IFRS 7.11A to require the above disclosure and the other existing disclosures to be disclosed for each class of investment.

The Amendments also require disclosure of any transfers of the cumulative gain or loss within equity during the reporting period related to the equity investments measured at FVOCI which were derecognised during that reporting period.

### Contractual terms that could change the timing or amount of contractual cash flows

PIR participants noted that understanding the effect of contractual terms that could change the timing or amount of contractual cash flows is important to their analysis and assessment of an entity's future cash flows. Prior to the Amendments, HKFRS/IFRS 7 did not specifically require an entity to disclose the effect of contractual terms that could change the timing or amount of the contractual cash flows of these financial instruments.

The Amendments require entities to provide the following disclosures related to the effect of contractual terms that could change the amount of contractual cash flows based on the occurrence (or non-occurrence) of a contingent event that does not relate directly to changes in basic lending risks and costs:

- a qualitative description of the nature of the contingent event;
- quantitative information about the possible changes to contractual cash flows that could result from those contractual terms; and
- the gross carrying amount of financial assets and the amortised cost of financial liabilities subject to those contractual terms.

### Effective date and transition

#### Effective date

The Amendments are effective for annual reporting periods beginning on or after 1 January 2026, with earlier application permitted.

The Amendments permit an entity to early adopt only the amendments related to the classification of financial assets and the related disclosures and apply the remaining amendments later. This would be particularly useful to entities that wish to apply the Amendments early for financial instruments with ESG-linked or similar features.

An entity is required to disclose the fact of early adoption.

It should be noted that in jurisdictions that require endorsement of IFRS Accounting Standards (eg the European Union), an entity would be able to apply the Amendments only after jurisdictional endorsement.

## Transition

The Amendments are required to be applied retrospectively, in accordance with the requirements of HKAS/IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Any difference in the carrying amounts is required to be recognised in opening retained earnings (or other component of equity, as appropriate). Restatement of prior periods is not required and is permitted only if it is possible to do so without the use of hindsight.

If the measurement category of a financial asset changes as a result of the application of the Amendments, the entity is required to disclose the measurement category and the carrying amount immediately before and immediately after the application of the Amendments.

## BDO's support and assistance on HKFRS/IFRS Accounting Standards

For any support and assistance on HKFRS/IFRS Accounting Standards, please talk to your usual BDO contact or email [info@bdo.com.hk](mailto:info@bdo.com.hk)

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