Late papers – NZASB Meeting 13 June 2024

Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Memorandum

Date:	7 June 2024
To:	NZASB Members
From:	Alex Stainer
Subject:	***Amendments to the Classification and Measurement of Financial Instruments* (Amendments to NZ IFRS 9 and NZ IFRS 7*)***

COVER SHEET

Project priority and complexity

Project priority	**Medium** *Amendments to the Classification and Measurement of Financial Instruments* is a targeted and narrow scope amending standard to respond to the Post Implementation Review (PIR) of IFRS 9—Classification and Measurement. The amendments address the derecognition of a financial liability that are settled using an electronic payment system, and the application of the requirements to assess contractual cash flow characteristics of financial assets with contingent features (such as financial assets with ESG-linked features) for the purpose of classification and measurement. These amendments relate to transactions that are becoming more prevalent in New Zealand.
Complexity of Board decision-making at this meeting	**Low** We are seeking approval to issue *Amendments to the Classification and Measurement of Financial Instruments*, which amends NZ IFRS 9 and NZ IFRS 7 and is identical in substance to *Amendments to the Classification and Measurement of Financial Instruments* issued by the International Accounting Standards Board (IASB).

Overview of agenda item

Project status	Approval – we are seeking approval to issue *Amendments to the Classification and Measurement of Financial Instruments.*
Project purpose	To alleviate diversity in practice by bringing in narrow scope amendments that clarify the treatment of certain financial instruments in response to the PIR of IFRS 9—Classification and Measurement.
Board action required at this meeting	APPROVAL to issue *Amendments to the Classification and Measurement of Financial Instruments* which amends NZ IFRS 9 and NZ IFRS 7. AGREEMENT to defer development of RDR concessions. AGREEMENT to defer development of equivalent amendments to the PBE Standards until the IPSASB has considered these amendments.

Recommendations[1]

1. We recommend that the Board:

   (a) APPROVES for issue *Amendments to the Classification and Measurement of Financial Instruments*, which amends NZ IFRS 9 *Financial Instruments* and NZ IFRS 7 *Financial Instruments: Disclosures*;

   (b) APPROVES the signing memorandum from the Chair of the NZASB to the Chair of the External Reporting Board requesting approval to issue *Amendments to the Classification and Measurement of Financial Instruments*;

   (c) AGREES to defer developing and consulting on RDR concessions for Tier 2 for-profit entities with respect to *Amendments to the Classification and Measurement of Financial Instruments*; and

   (d) CONSIDERS the application of the PBE Policy Approach and AGREES to defer the decision to develop amendments to PBE Standards based on *Amendments to the Classification and Measurement of Financial Instruments* until the IPSASB has completed its equivalent alignment project.

Background

2. The International Accounting Standards Board (IASB) issued Exposure Draft ED/2023/2 *Amendments to the Classification and Measurement of Financial Instruments* (the ED) in March 2023.

3. The NZASB issued the ED for comment in New Zealand around the same time. Comments were due to the NZASB on 7 June 2023 and to the IASB on 19 July 2023.

4. The NZASB commented on the ED. We were broadly supportive of the ED proposals, but recommended some improvements. Our comment letter was informed by informal feedback from New Zealand constituents. No formal submissions were received. The IASB received 109 comment letters from its world-wide constituents. The IASB received 1 other comment direct from New Zealand constituents (a joint comment letter from Chartered Accountants Australia and New Zealand and CPA Australia).

5. The IASB issued *Amendments to the Classification and Measurement of Financial Instruments* in May 2024, which is mandatory for annual periods beginning on or after 1 January 2026.

Reasons for amendments

6. The IASB proposed amendments to IFRS 9 *Financial Instruments* and IFRS 7 *Financial Instruments: Disclosures* in response to feedback received as part of the Post-implementation Review (PIR) of IFRS 9—Classification and Measurement. The IASB concluded that, in general, the classification and measurement requirements of IFRS 9 can be applied consistently and that in doing so an entity provides useful information to users of its financial statements.

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[1] This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Accounting Standards, IFRIC® Interpretations and IASB® papers).

However, the IASB also concluded that, in relation to some matters, the requirements should be clarified to improve their understandability and address application challenges. Accordingly, the IASB decided to make narrow-scope amendments to the requirements related to the following:

(a) Settling financial liabilities using an electronic payment system
This matter originated from a request to the IFRS Interpretations Committee (Committee) which related to the recognition of cash received via an electronic payment system as settlement for a financial asset[2]. Respondents who commented on the Committee's tentative agenda decision expressed concerns about the potential outcomes of that tentative decision, especially in the context of the settlement of financial liabilities. The amendments have addressed these concerns.

(b) Assessing contractual cash flow characteristics of financial assets, including those with environmental, social and governance (ESG)-linked features
The IASB decided to clarify the application of the requirements for assessing the contractual cash flow characteristics (also known as the 'solely payments of principal and interest' test) for financial assets, including financial assets with ESG-linked features. This assessment is important to determine whether to classify and measure such financial assets at:

- amortised cost; or
- fair value through profit or loss.

This clarification was required to avoid diversity in practice, particularly with the increased use of financial assets with ESG-linked features.

Summary of main amendments

7. The amending Standard has in substance remained reasonably consistent with the proposals outlined in the ED. However, the following revisions that the IASB made to the ED proposals in response to feedback received are worth noting:

   (a) ***Derecognition of financial liabilities settled via electronic payment systems:***
   While the ED proposed to emphasise that both financial assets and financial liabilities are generally recognised and derecognised using 'settlement date accounting', the amendments in the final pronouncement refer to 'settlement date' only in the context of derecognising a financial liability.
   In addition, the IASB refined the wording of the conditions required for derecognising a financial liability settled via an electronic payment system before 'settlement date', by referring to having no *practical* ability to withdraw, stop or cancel the payment instruction. This change is consistent with the NZASB's recommendations.

   (b) ***Clarifying application of the classification requirements for financial assets:***
   The ED proposed that for a financial asset with contingent features to be consistent with a basic lending arrangement (and therefore meet the 'solely payments of principal and interest' test and be measured at amortised cost), the contingent event must be specific

[2] For the tentative Agenda Decision: *Cash received via Electronic Transfer as Settlement for a Financial Asset* click here.

to the debtor. Some stakeholders, including the NZASB, expressed concerns about this proposal – noting that it not necessarily consistent with the concept of a basic lending arrangement as described in IFRS 9. Consequently, the IASB's final pronouncement does not refer to contingent events that are specific to the debtor. This change is consistent with the NZASB's recommendations.

Instead, the IASB's finalised amendments explain that when a contingent feature does not directly relate to changes in basic lending risks and costs, but the cash flows before and after the contingent event are consistent with a basic lending arrangement (as described in IFRS 9) and are not significantly different to the cash flows of a financial asset with identical terms but without the contingent feature, the financial asset can still be consistent with a basic lending arrangement (see the table below).

8. A summary of the main amendments are outlined in Table 1 below.

Table 1 – Summary of main amendments

Amendment	Description
Derecognition of a financial liability upon initiating payment via electronic payment system	NZ IFRS 9 generally requires financial liabilities to be derecognised on the settlement date, which is the date on which the liability is extinguished, i.e. when the obligation specified in the contract is discharged or cancelled or expires. The amendments clarify that for financial liabilities settled in cash via an electronic payment system, an entity can derecognise a financial liability prior to settlement date if the entity has met the following criteria upon initiating the payment instruction: o they have no practical ability to withdraw, stop or cancel payment instructions; o they have no practical ability to access the cash; and o there is an insignificant settlement risk.
Provides further clarification for financial assets on how they can be consistent with a basic lending arrangement and therefore recorded at amortised cost (including those that have ESG-linked features)	The amendments add the following guidance in the assessment of whether a financial asset is consistent with a basic lending arrangement (and therefore meet the 'solely payments of principal and interest' test and be measured at amortised cost): o Entities should focus on the reason for the compensation/interest (rather than amount). o If contractual cash flows are indexed to a variable that is not a basic lending risk or cost this is inconsistent with a basic lending arrangement. For those financial assets with contractual terms (or contingent features) that could result in cash flows changing, the following guidance was added (along with the provision of two examples): o Cash flows before and after the trigger of the contractual terms should be considered, irrespective of the probability of the change in contractual cash flows occurring.

	○ The nature of the contingent event and whether it relates directly to changes in basic lending risks and costs should be considered. ○ In some cases, a contingent feature gives rise to contractual cash flows that are consistent with a basic lending arrangement as described in IFRS 9, both before and after the contingent event, but the nature of the contingent event itself (e.g. meeting an ESG-linked target) does not relate directly to changes in basic lending risks and costs. In such cases, the financial asset can still be consistent with a basic lending arrangement. However, this is only the case if the contractual cash flows (both before and after the contingent event occurring) would not be significantly different from the contractual cash flows on a financial instrument with identical contractual terms, but without such a contingent feature. Guidance is also added for other types of financial assets that: ○ Outlines what financial assets with non-recourse features are, and considerations when assessing if the cash flows are consistent with a basic lending arrangement. ○ Specifies where transactions that involve multiple contractually linked instruments (to determine payments to holders of financial assets) need to be assessed differently to determine whether they are consistent with a basic lending arrangement.
Amended and added disclosures for investments in equity instruments designated at fair value through other comprehensive income (OCI)	The ED amends the disclosures in IFRS 7 to apply to each *class* of investment in equity instruments classified as fair value through OCI (rather than for each such investment) Introduces a disclosure to differentiate changes in fair value between those related to investments derecognised during the period and those related to investments held at the end of the period.
Added disclosures for financial instruments with contingent features	Introduces disclosures for financial instruments with contingent features that require: ○ a qualitative description of the nature of the contingent event, and ○ quantitative information about changes to contractual cash flows from the gross carrying amount of financial assets and the amortised cost of financial liabilities subject to those terms.

RDR concessions

9. We are proposing to defer developing and consulting on proposed RDR concessions until our approach to Tier 2 for-profit disclosure requirements is confirmed, as part of our project to consider the requirements in IFRS 19 *Subsidiaries without Public Accountability: Disclosures*.

10. Furthermore, the IASB have noted they will publish a 'catch-up' exposure draft relating to IFRS 19 *Subsidiaries without Public Accountability: Disclosures* later in 2024, that will[3]:
    (a) not include the prospective amendments to IFRS 7 relating to equity instruments designated at fair value through other comprehensive income; and
    (b) include the prospective amendments to IFRS 7 relating to changes in contractual cash flows.

11. As we currently do not have a New Zealand equivalent of IFRS 19, we have not included the changes in the paragraph above in the New Zealand equivalent amending Standard, and will therefore wait upon the release of the IASB 'catch up' exposure draft and the finalisation of our approach to Tier 2 disclosure requirements in light of IFRS 19 to consider these changes.

12. Upon confirming the approach to IFRS 19, we will be able to move forward with more certainty in terms of whether and what concessions should be provided for Tier 2 entities with respect to the disclosures added by *Amendments to the Classification and Measurement of Financial Instruments.*

Consistency with Australian Accounting Standards

13. As at the date of this memo, we have reached out to Staff of the Australian Accounting Standards Board (AASB) to understand when the amendments will be brought before the AASB. We will provide a verbal update of AASB Staff plans at the Board meeting and whether there is consistency with our approach.

Due process

14. Following its consideration of comments from constituents, the IASB reviewed the due process steps that it had taken since the publication of the ED and concluded that the applicable due process steps had been completed. This review of due process occurred at the IASB's February 2024 meeting.[4]

15. The due process followed by the NZASB complied with the due process requirements established by the XRB Board and, in our view, meets the requirements of section 22 of the Financial Reporting Act 2013.

16. In accordance with section 22(2) of the Financial Reporting Act 2013 we have considered whether the amending standard is likely to require the disclosure of personal information. In our view the amending standard does not include requirements that would result in the

[3] The IASB have included this position in the published amending Standard.

[4] A summary of the IASB's February 2024 meeting is available at: IFRS - IASB Update February 2024

disclosure of personal information, and therefore no consultation with the Privacy Commissioner is required.

Commencement and application

17. Section 28 of the Financial Reporting Act states that the accounting periods in relation to which a standard or amendment commence to apply "must not be accounting periods or interim accounting periods that have ended or that end before the standard, authoritative notice, amendment, or revocation takes effect". Furthermore, the Legislation Act 2019 does not allow legislation to have retrospective effect in New Zealand.

18. We have considered whether any modifications to *Amendments to the Classification and Measurement of Financial Instruments* are needed to ensure consistency with the abovementioned legislative restrictions.

Mandatory date

19. As shown in Agenda Item 6.2, *Amendments to the Classification and Measurement of Financial Instruments* will be applicable to New Zealand for-profit entities for annual reporting periods beginning on or after 1 January 2026 – with earlier application permitted for accounting periods that begin before this date, but which do not end before it takes effect (standards take effect on the 28th day after gazetting). This is consistent with the effective date established by the IASB, to the extent permitted under section 28 of the Financial Reporting Act 2013.

Use of the term 'retrospective'

20. In *Amendments to the Classification and Measurement of Financial Instruments* as issued by the IASB, in the transition section, paragraph 7.2.47 referred to retrospective application in accordance with IAS 8. While such retrospective application does not constitute 'retrospective effect' for legislative purposes, we have amended the abovementioned wording to avoid perceived inconsistency with the Legislation Act 2019 (see above) – using the same wording that we used in other recent amendments in similar situations.

21. Therefore, in the draft New Zealand amending standard in Agenda Item 6.2, paragraph 7.2.47 has been modified as follows: "An entity shall apply *Amendments to the Classification and Measurement of Financial Instruments* ~~retrospectively~~ as if they had always been applied, in accordance with NZ IAS 8 […]"

Draft amending standard and signing memorandum

22. Attached as agenda item 6.2 is a copy of *Amendments to the Classification and Measurement of Financial Instruments*.

23. Attached as agenda item 6.3 is a draft signing memorandum from the Chair of the NZASB to the Chair of the External Reporting Board.

Questions for the Board
Q1. Does the Board APPROVE for issue *Amendments to the Classification and Measurement of Financial Instruments* which amends NZ IFRS 9 and NZ IFRS 7?
Q2. Does the Board APPROVE the signing memorandum from the Chair of the NZASB to the Chair of the External Reporting Board, requesting approval to issue the amending standard?
Q3. Does the Board agree to defer the development and consultation for RDR concessions with respect to *Amendments to the Classification and Measurement of Financial Instruments* until the approach for Tier 2 for-profit entities with respect to IFRS 19 *Subsidiaries without Public Accountability* is confirmed?

PBE Policy Approach

24. As *Amendments to the Classification and Measurement of Financial Instruments* amends IFRS 9 and IFRS 7, which are used as the basis for IPSAS 41 *Financial Instruments* and IPSAS 30 *Financial Instruments: Disclosures* respectively, we are required to apply the PBE Policy Approach to determine whether to propose amendments to the PBE Standards.

25. The PBE Policy Approach establishes a rebuttable presumption that, in the case of limited-scope amendments or amendments to an NZ IFRS that the NZASB considers are minor, the NZASB should not incorporate the change into the equivalent PBE Standard in advance of the IPSASB.

26. Table 2 below considers the factors in the development principle as it applies to *Amendments to the Classification and Measurement of Financial Instruments*

Table 2 – Application of the PBE Policy Approach to *Amendments to the Classification and Measurement of Financial Instruments*

Are the amendments minor?
Yes – these are limited scope amendments. The amendment in relation to the derecognition of a financial liability is a targeted and narrow scope amendment likely to not have a great deal of consequence in the NZ market given our banking arrangements. We consider the additional guidance in assessing whether the contractual cash flows for financial assets are consistent with a basic lending arrangement are minor as they provide clarification of existing requirements. The disclosures introduced for transactions with contingent features and investments in equity instruments fair value through other comprehensive income are also limited scope for which we do not anticipate there being much impact in the PBE sector.

Will the IPSASB consider these amendments in an acceptable timeframe?
Yes, as the IPSASB is monitoring *Amendments to the Classification and Measurement of Financial Instruments* in respect of IPSAS 30 and 41, we expect that the amendments will be considered in an acceptable timeframe. The IPSASB's most recent IPSAS-IFRS Alignment Dashboard indicates that the IPSASB expects to consider these amendments as part of *Improvements to IPSAS 2025*.
Will the potential development lead to higher quality financial reporting?
Yes. The amending standard provides better quality disclosures and clarifications that alleviate diversity in practice. However, we do not expect that the issues addressed by the amendments are prevalent in the PBE sector in New Zealand and therefore the extent of improvement will be limited.
Will the benefits outweigh the costs?
No. *Relevant to the PBE sector as a whole?* We do not have any indication that the issues that are being addressed by *Amendments to the Classification and Measurement of Financial Instruments* are common issues for the PBE sector in New Zealand. *Whether the benefits will outweigh the costs* We do not consider the benefits of incorporating the amendments into the PBE Standards would outweigh the costs of doing so ahead of the IPSASB. *Coherence of the suite of PBE Standards* The amendments would affect only PBE IPSAS 41 and PBE IPSAS 30. There are no consequential amendments to other PBE Standards so the coherence of the suite of PBE Standards would be maintained. *Impact on mixed groups* Developing amendments to the PBE Standards would promote a consistent approach and could have a positive impact on mixed groups. However, the impact of not introducing them to the PBE Standards at this time is likely to be limited given the existing banking arrangements in NZ and the relative rarity of ESG linked financial instruments for NZ PBE entities at this time.

Staff recommendation

27. We do not consider there is sufficient evidence to rebut the presumption that the NZASB will not incorporate the amendments into the equivalent PBE Standards in advance of the IPSASB. Therefore, our recommendation is to defer the decision to develop a PBE Standard based on *Amendments to the Classification and Measurement of Financial Instruments* until the IPSASB has developed their amendments.

Question for the Board

Q4. Does the Board AGREE to defer the decision to develop a PBE Standard based on *Amendments to the Classification and Measurement of Financial Instruments* until the IPSASB has completed its equivalent alignment project?

XRB | Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Amendments to the Classification and Measurement of Financial Instruments

Amendments to NZ IFRS 9 and NZ IFRS 7

Mandatory from 1 January 2026

Issued June 2024

Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Amendments to the Classification and Measurement of Financial Instruments

Issued June 2024

This Tier 1 and Tier 2 for-profit amending Standard is based on *Amendments to the Classification and Measurement of Financial Instruments,* issued by the International Accounting Standards Board, which amended IFRS 9 *Financial Instruments* and IFRS 7 *Financial Instruments: Disclosures.* This amending Standard provides clarifications on accounting for the settlement of liabilities through electronic payment systems, and on the application of the classification requirements for financial assets, including financial assets with environmental, social and corporate governance and similar features. It also introduces new disclosures for investments in equity instruments designated at fair value through other comprehensive income and financial instruments with contingent features.

In finalising this Standard, the New Zealand Accounting Standards Board has carried out appropriate consultation in accordance with section 22(1) of the Financial Reporting Act 2013.

Legal status of amending Standard

This amending Standard was issued on XX June 2024 by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 12(a) of the Financial Reporting Act 2013.

This amending Standard is secondary legislation for the purposes of the Legislation Act 2019.

The amending Standard, pursuant to section 27(1) of the Financial Reporting Act 2013, takes effect on the 28th day after the date of its publication. The amending Standard was published under the Legislation Act 2019 on XX June 2024 and takes effect on XX July 2024.

Commencement and application

The amending Standard has a mandatory date of 1 January 2026, meaning it must be applied by Tier 1 and Tier 2 for-profit entities for accounting periods that begin on or after this date.

Application to an earlier accounting period is permitted for accounting periods that end after this amending Standard takes effect – refer to paragraph NZ 7.1.13A–NZ 7.1.13C of this amending Standard.

AMENDMENTS TO THE CLASSIFICATION AND MEASUREMENT OF FINANCIAL INSTRUMENTS

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The following is available within New Zealand on the XRB website as additional material

Part A – Introduction

This amending Standard sets out amendments to NZ IFRS 9 *Financial Instruments* and NZ IFRS 7 *Financial Instruments: Disclosures*. The amendments are identical to *Amendments to the Classification and Measurement of Financial Instruments* (Amendments to IFRS 9 and IFRS 7), issued by the International Accounting Standards Board (IASB). This amending Standard provides clarifications on accounting for the settlement of liabilities through electronic payment systems, and on the application of the classification requirements for financial assets, including financial assets with environmental, social and corporate governance and similar features. It also introduces new disclosures for investments in equity instruments designated at fair value through other comprehensive income and financial instruments with contingent features.

Tier 2 entities are required to comply with all the requirements in this amending Standard.

Part B – Scope

This Standard applies to Tier 1 and Tier 2 for-profit entities.

Part C – Amendments to NZ IFRS 9 *Financial Instruments*

Paragraphs 7.1.12–7.1.13, NZ 7.1.13A–NZ 7.1.13C, and 7.2.47–7.2.49 and the heading before paragraph 7.2.47 are added. For ease of reading these paragraphs have not been underlined.

7.1 ~~Effective date~~ Commencement and application

...

7.1.12 *Amendments to the Classification and Measurement of Financial Instruments*, which amended NZ IFRS 9 and NZ IFRS 7, issued in June 2024, added paragraphs 7.2.47–7.2.49, B3.1.2A, B3.3.8–B3.3.10, B4.1.8A, B4.1.10A, B4.1.16A and B4.1.20A. It also amended paragraphs B4.1.10, B4.1.13, B4.1.14, B4.1.16, B4.1.17, B4.1.20, B4.1.21 and B4.1.23. An entity shall apply these amendments in accordance with the commencement and application date provisions in paragraphs NZ 7.1.13A–NZ 7.1.13C. An entity that applies those amendments to an 'early adoption accounting period' shall disclose that fact.

7.1.13 If an entity elects to apply these amendments to an 'early adoption accounting period' it shall either:

(a) apply all the amendments at the same time and disclose that fact; or

(b) apply only the amendments to the Application Guidance to Section 4.1 of this Standard (Classification of financial assets) for that earlier period and disclose that fact.

When amending Standard takes effect (section 27 Financial Reporting Act 2013)

NZ 7.1.13A The amending Standard takes effect on the 28th day after the date of its publication under the Legislation Act 2019. The amending Standard was published on XX June 2024 and takes effect on XX July 2024.

Accounting period in relation to which standards commence to apply (section 28 Financial Reporting Act)

NZ 7.1.13B The accounting periods in relation to which this amending Standard commences to apply are:

(a) for an **early adopter**, those accounting periods following and including, the **early adoption accounting period**.

(b) for any other reporting entity, those accounting periods following, and including, the first accounting period for the entity that begins on or after the **mandatory date.**

NZ 7.1.13C In paragraph NZ 7.1.13B:

early adopter means a reporting entity that applies this amending Standard for an early adoption accounting period

early adoption accounting period means an accounting period of the early adopter:

(a) that begins before the mandatory date but has not ended or does not end before this amending Standard takes effect (and to avoid doubt, that period may have begun before this amending Standard takes effect); and

(b) for which the early adopter:

  (i) first applies this amending Standard in preparing its financial statements; and

  (ii) discloses in its financial statements for that accounting period that this amending Standard has been applied for that period.

mandatory date means 1 January 2026.

7.2 Transition

...

Transition for *Amendments to the Classification and Measurement of Financial Instruments*

7.2.47 An entity shall apply *Amendments to the Classification and Measurement of Financial Instruments* as if they had always been applied, , in accordance with NZ IAS 8, except as specified in paragraphs 7.2.48–7.2.49. For the purposes of the requirements in these paragraphs, the date of initial application is the beginning of the annual reporting period in which the entity first applies the amendments.

7.2.48 An entity is not required to restate prior periods to reflect the application of these amendments. An entity may restate prior periods if, and only if, it is possible to do so without the use of hindsight. If an entity does not restate prior periods, it shall recognise the effect of initially applying these amendments as an adjustment to the opening balance of financial assets and financial liabilities and the cumulative effect, if any, as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the date of initial application.

7.2.49 At the date of initial application of the amendments to the Application Guidance to Section 4.1 of this Standard (Classification of financial assets), an entity shall disclose for each class of financial assets that changed measurement category as a result of applying the amendments:

(a) the measurement category and carrying amount determined immediately before the amendments were applied; and

(b) the measurement category and carrying amount determined immediately after the amendments were applied.

Appendix B
Application guidance

Paragraphs B3.1.2A, B3.3.8–B3.3.10, B4.1.8A, B4.1.10A, B4.1.16A and B4.1.20A and the heading before paragraph B3.1.2A are added. Paragraphs B4.1.10, B4.1.13, B4.1.14, B4.1.16, B4.1.17, B4.1.20, B4.1.21 and B4.1.23 are amended. Paragraphs B4.1.7A, B4.1.15 and B4.1.22 are not amended but are included for ease of reference. New text is underlined and deleted text is struck through.

Recognition and derecognition (Chapter 3)

Initial recognition (Section 3.1)

...

Date of initial recognition or derecognition

B3.1.2A Unless paragraph 3.1.2 applies, an entity shall recognise a financial asset or financial liability on the date on which the entity becomes party to the contractual provisions of the instrument (see paragraph 3.1.1). A financial asset is derecognised on the date on which the contractual rights to the cash flows expire or the asset is transferred (see paragraph 3.2.3). Unless an entity elects to apply paragraph B3.3.8, 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 (see paragraph 3.3.1) or the liability otherwise qualifies for derecognition (see paragraph 3.3.2).

...

Derecognition of financial liabilities (Section 3.3)

...

B3.3.8 Despite the requirement in paragraph B3.1.2A to derecognise a financial liability on the settlement date, when settling a financial liability (or part of a financial liability) in cash using an electronic payment system, an entity is permitted to deem the financial liability (or part of it) to be discharged before the settlement date if, and only if, the entity has initiated a payment instruction that resulted in:

(a) the entity having no practical ability to withdraw, stop or cancel the payment instruction;

(b) the entity having no practical ability to access the cash to be used for settlement as a result of the payment instruction; and

(c) the settlement risk associated with the electronic payment system being insignificant.

B3.3.9 For the purpose of applying paragraph B3.3.8(c), settlement risk associated with an electronic payment system is insignificant if its characteristics are such that completion of the payment instruction follows a standard administrative process and the time between the criteria in paragraphs B3.3.8(a) and (b) being met and the cash being delivered to the counterparty is short. However, 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.

B3.3.10 An entity that elects to apply paragraph B3.3.8 to the settlement of a financial liability (or part of a financial liability) using an electronic payment system shall apply that paragraph to all settlements made through the same electronic payment system.

Classification (Chapter 4)

Classification of financial assets (Section 4.1)

...

Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding

...

B4.1.7A 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 (see paragraphs B4.1.9A–B4.1.9E) 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. In extreme economic circumstances, interest can be negative if, for example, the holder of a financial asset either explicitly or implicitly pays for the deposit of its money for a particular period of time (and that fee exceeds the consideration that the holder receives for the time value of money, credit risk and other basic lending risks and costs). However, contractual terms that introduce exposure to risks or volatility in the contractual cash flows that is unrelated to a basic lending arrangement, such as exposure to changes in equity prices or commodity prices, do not give rise to contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. An originated or a purchased financial asset can be a basic lending arrangement irrespective of whether it is a loan in its legal form.

...

<u>B4.1.8A</u> <u>In assessing whether the contractual cash flows of a financial asset are consistent with a basic lending arrangement, an entity may have to consider the different elements of interest separately. The assessment of interest focuses on *what* an entity is being compensated for, rather than *how much* compensation an entity receives. Nonetheless, 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.</u>

...

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

B4.1.10 If a financial asset contains a contractual term that could change the timing or amount of contractual cash flows (for example, if the asset can be prepaid before maturity or its term can be extended), the entity must determine whether the contractual cash flows that could arise over the life of the instrument due to that contractual term are solely payments of principal and interest on the principal amount outstanding. 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<u>, irrespective of the probability of the change in contractual cash flows occurring</u>. 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. 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. For example, compare a financial instrument with an interest rate that is reset to a higher rate if the debtor misses a particular number of payments to a financial instrument with an interest rate that is reset to a higher rate if a specified equity index reaches a particular level. It is more likely in the former case that the contractual cash flows over the life of the instrument will be solely payments of principal and interest on the principal amount outstanding because of the relationship between missed payments and an increase in credit risk.<u> In the former case, 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.</u> (See also paragraph B4.1.18.)

<u>B4.1.10A</u> <u>In some cases, a 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. For example, the interest rate on a loan is adjusted by a specified amount if the debtor achieves a contractually specified reduction in carbon emissions. In such a case, when applying paragraph B4.1.10, the financial asset has contractual cash flows that are solely payments of principal and interest on the principal amount outstanding 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. In some circumstances, the entity may be able to make that determination by performing a qualitative assessment; but, in other circumstances, it may be necessary to</u>

perform a quantitative assessment. If it is clear, with little or no analysis, that the contractual cash flows are not significantly different, an entity need not perform a detailed assessment.

...

B4.1.13 The following examples illustrate contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. This list of examples is not exhaustive.

Instrument	Analysis
... **Instrument EA** 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. The maximum possible cumulative adjustments would not significantly change the interest rate on the loan.	... The contractual cash flows are solely payments of principal and interest on the principal amount outstanding. The entity considers whether the contractual cash flows that could arise both before and after each change in contractual cash flows are solely payments of principal and interest (see paragraph B4.1.10). 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. It is only because the nature of the contingent event itself does not relate directly to changes in basic lending risks and costs that the entity cannot conclude – without further assessment – whether the cash flows on the financial asset are solely payments of principal and interest. The entity therefore assesses whether, 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 the contingent feature linked to carbon emissions (see paragraph B4.1.10A). Because any adjustments over the life of the instrument would not result in contractual cash flows that are significantly different, the entity concludes that the loan has contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.

B4.1.14 The following examples illustrate contractual cash flows that are not solely payments of principal and interest on the principal amount outstanding. This list of examples is not exhaustive.

Instrument	Analysis
... **Instrument I** Instrument I 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 not solely payments of principal and interest on the principal amount outstanding. 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

Instrument	Analysis
	arrangement (see paragraph B4.1.8A).

B4.1.15 In some cases a financial asset may have contractual cash flows that are described as principal and interest but those cash flows do not represent the payment of principal and interest on the principal amount outstanding as described in paragraphs 4.1.2(b), 4.1.2A(b) and 4.1.3 of this Standard.

B4.1.16 This may be the case if the financial asset represents an investment in particular assets or cash flows and hence the contractual cash flows are not solely payments of principal and interest on the principal amount outstanding. For example, if the contractual terms stipulate that the financial asset's cash flows increase as more automobiles use a particular toll road, those contractual cash flows are inconsistent with a basic lending arrangement. As a result, the instrument would not satisfy the condition in paragraphs 4.1.2(b) and 4.1.2A(b). ~~This could be the case when a creditor's claim is limited to specified assets of the debtor or the cash flows from specified assets (for example, a 'non-recourse' financial asset).~~

B4.1.16A The situation described in paragraph B4.1.15 may also arise if a financial asset has '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. In other words, the entity is primarily exposed to the specified assets' performance risk rather than the debtor's credit risk. For example, a creditor's ultimate right to receive cash flows may be contractually limited to the cash flows generated by specified assets of a structured entity.

B4.1.17 However, the fact that a financial asset ~~is~~ has non-recourse features does not in itself necessarily preclude the financial asset from meeting the condition in paragraphs 4.1.2(b) and 4.1.2A(b). In such situations, the creditor is required to assess ('look through to') the link between the particular underlying assets or cash flows and the contractual cash flows of the financial asset being classified to determine whether those ~~the~~ contractual cash flows ~~of the financial asset being classified~~ are payments of principal and interest on the principal amount outstanding. An entity shall also consider how this link is affected by other contractual arrangements, such as subordinated debt or equity instruments issued by the debtor. If the terms of the financial asset give rise to any other cash flows or limit the cash flows in a manner inconsistent with payments representing principal and interest, the financial asset does not meet the condition in paragraphs 4.1.2(b) and 4.1.2A(b). Whether the underlying assets are financial assets or non-financial assets does not in itself affect this assessment.

...

Contractually linked instruments

B4.1.20 In some types of transactions with non-recourse features, an issuer may prioritise payments to the holders of financial assets using multiple contractually linked instruments ~~that create concentrations of credit risk~~ (tranches). Each tranche has a subordination ranking that specifies the order in which any cash flows generated by the issuer from the underlying pool of financial instruments are allocated to the tranche. The prioritisation of payments to the holders of these tranches is established through a waterfall payment structure that creates concentrations of credit risk and results in a disproportionate allocation of cash shortfalls from the underlying pool between the tranches. In such situations, the holders of a tranche have the right to payments of principal and interest on the principal amount outstanding only if the issuer generates sufficient cash flows to satisfy higher-ranking tranches. In these types of transactions, the holders of a tranche apply paragraphs B4.1.21–B4.1.26 instead of paragraph B4.1.17.

B4.1.20A Some transactions that may contain multiple debt instruments and appear to have the characteristics described in paragraph B4.1.20 are, in fact, lending arrangements that are structured to provide enhanced credit protection to a creditor (or group of creditors). For example, a structured entity may be set up to hold the underlying assets that will generate the cash flows to repay the creditor. The structured entity issues senior and junior debt instruments. The creditor holds the senior debt instrument and the entity sponsoring the structured entity that holds the junior debt instrument has no practical ability to sell the junior instrument without the senior debt instrument becoming payable. The holders of such debt instruments apply paragraphs B4.1.7–B4.1.19 instead of paragraphs B4.1.21–B4.1.26.

B4.1.21 In ~~such~~ transactions that contain contractually linked instruments, as described in paragraph B4.1.20, a tranche has cash flow characteristics that are payments of principal and interest on the principal amount outstanding only if:

(a) ...

B4.1.22 An entity must look through until it can identify the underlying pool of instruments that are creating (instead of passing through) the cash flows. This is the underlying pool of financial instruments.

B4.1.23 The underlying pool must contain one or more instruments that have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. For the purposes of this assessment, the underlying pool can include financial instruments that are not within the scope of the classification requirements (see Section 4.1) but that have contractual cash flows that are equivalent to solely payments of principal and interest on the principal amount outstanding—for example, some lease receivables. However, lease receivables that are subject to residual value risk, or that comprise variable lease payments that are indexed to a variable that is not a basic lending risk or cost (for example, a market rental rate), do not have contractual cash flows that are equivalent to solely payments of principal and interest on the principal amount outstanding.

Amendments to NZ IFRS 7 *Financial Instruments: Disclosures*

Paragraphs 20B, 20C, 20D, 44LL and 44MM are added. For ease of reading these paragraphs have not been underlined. Paragraphs 11A and 11B are amended. New text is underlined and deleted text is struck through.

Significance of financial instruments for financial position and performance

...

Statement of financial position

...

Investments in equity instruments designated at fair value through other comprehensive income

11A If an entity has designated investments in equity instruments to be measured at fair value through other comprehensive income, as permitted by paragraph 5.7.5 of NZ IFRS 9, it shall disclose<u> for each class of investment</u>:

(a) ...

(b) ...

(c) the fair value~~ of each such investment~~ at the end of the reporting period.

(d) ...

(e) ...

<u>(f)</u> <u>the fair value gain or loss presented in other comprehensive income 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.</u>

11B If an entity derecognised investments in equity instruments measured at fair value through other comprehensive income during the reporting period, it shall disclose:

(a) ...

(b) ...

(c) ...

<u>(d)</u> <u>any transfers of the cumulative gain or loss within equity during the reporting period related to the investments derecognised during that reporting period.</u>

...

Statement of comprehensive income

Items of income, expense, gains or losses

...

20B An entity shall disclose the information required by paragraph 20C by class of financial assets measured at amortised cost or fair value through other comprehensive income and by class of financial liabilities measured at amortised cost. The entity shall consider how much detail to disclose, the appropriate level of aggregation or disaggregation, and whether users of financial statements need additional explanations to evaluate any quantitative information disclosed.

20C To enable users of financial statements to understand 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 (such as the time value of money or credit risk), an entity shall disclose:

(a) a qualitative description of the nature of the contingent event;

(b) quantitative information about the possible changes to contractual cash flows that could result from those contractual terms (for example, the range of possible changes); and

(c) the gross carrying amount of financial assets and the amortised cost of financial liabilities subject to those contractual terms.

20D For example, an entity shall disclose the information required by paragraph 20C for a class of financial liabilities measured at amortised cost whose contractual cash flows change if the entity achieves a reduction in its carbon emissions.

...

~~Effective date and transition~~ Commencement and application

...

44LL *Amendments to the Classification and Measurement of Financial Instruments*, issued in June 2024, added paragraphs 20B, 20C and 20D and amended paragraphs 11A and 11B. An entity shall apply these amendments when it applies the amendments to NZ IFRS 9 in accordance with paragraphs 7.1.12–NZ7.1.13C of NZ IFRS 9. If an entity elects to apply only the amendments to the Application Guidance to Section 4.1 of NZ IFRS 9 (Classification of financial assets) for an earlier period in accordance with paragraph 7.1.13(b) of NZ IFRS 9, the entity shall also apply paragraphs 20B, 20C and 20D of this Standard at the same time. In either case, the entity need not provide the disclosures required by the amendments for any period presented before the date of its initial application of the amendments.

44MM In the reporting period in which an entity first applies *Amendments to the Classification and Measurement of Financial Instruments*, the entity is not required to disclose the information that would otherwise be required by paragraph 28(f) of NZ IAS 8.

Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Memorandum

Date:	7 June 2024
To:	Michele Embling, Chair External Reporting Board
From:	Carolyn Cordery, Chair NZASB
Subject:	***Amendments to Classification and Measurement of Financial Instruments*** **(Amendments to NZ IFRS 9 and NZ IFRS 7)**

Introduction[1]

1. In accordance with the protocols established by the External Reporting Board, NZASB seeks your approval to issue *Amendments to Classification and Measurement of Financial Instruments* which amends NZ IFRS 9 *Financial Instruments* and NZ IFRS 7 *Financial Instruments: Disclosure.*

2. These amendments respond to feedback from the 2022 Post-implementation Review of IFRS 9 and clarify the requirements in areas where stakeholders have raised concerns, or where new issues have emerged since IFRS 9 was issued. The amendments address diversity in accounting practice by making the requirements more understandable and consistent.

3. The key amendments in *Amendments to Classification and Measurement of Financial Instruments* are:

   (a) Amendments that allow entities to derecognise a financial liability settled via an electronic payment system before the 'settlement date', provided that the entity has initiated the payment and certain conditions are met; and

   (b) Clarification of the classification requirements for financial assets, including financial assets with features relating to economic, social or governance (ESG) targets – to help entities in determining whether such financial assets should be classified and measured at amortised cost or at fair value through profit or loss.

Due process

4. The International Accounting Standards Board (IASB) issued Exposure Draft ED/2023/2 *Amendments to the Classification and Measurement of Financial Instruments* (the ED) in March 2023.

5. The NZASB issued the ED for comment in New Zealand around the same time. Comments were due to the NZASB on 7 June 2023 and to the IASB on 19 July 2023.

6. The NZASB submitted a comment letter on ED/2023/2, which was informed by informal feedback received from New Zealand constituents. No formal submissions were received. The IASB received 109 comment letters from its world-wide constituents. The IASB received 1

[1] This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Accounting Standards, IFRIC® Interpretations and IASB® papers).

other comment direct from New Zealand constituents (A joint comment letter from Chartered Accountants Australia and New Zealand and CPA Australia).

7. Following its consideration of comments from constituents, the IASB reviewed the due process steps that it had taken since the publication of the ED and concluded that the applicable due process steps had been completed. This review of due process occurred at the IASB's February 2024 meeting.[2]

8. The IASB issued *Amendments to the Classification and Measurement of Financial Instruments* in May 2024, which is mandatory for annual periods beginning on or after 1 January 2026.

9. The NZASB has approved *Amendments to the Classification and Measurement of Financial Instruments*. The due process followed by the NZASB complied with the due process requirements established by the XRB Board and, in the NZASB's view, meets the requirements of section 22 of the Financial Reporting Act 2013.

10. In accordance with section 22(2) of the Financial Reporting Act 2013 the NZASB has considered whether the amending standard is likely to require the disclosure of personal information. In the NZASB's view the amending standard does not include requirements that would result in the disclosure of personal information and therefore no consultation with the Privacy Commissioner is required.

Consistency with XRB Financial Reporting Strategy

11. The amending standard is a standard in its own right. The amending standard is identical to *Amendments to the Classification and Measurement of Financial Instruments* issued by the IASB, except for the following:

    (a) A New Zealand specific introduction, formatting and numbering;

    (b) A scope paragraph explaining that the standard applies to Tier 1 and Tier 2 for-profit entities;

    (c) New Zealand specific wording for the commencement and application of the amending standard; and

    (d) The removal of amendments for IFRS 19 *Subsidiaries without Public Accountability*, noting that there is currently no New Zealand equivalent of that Standard and we are in the process of considering our approach to IFRS 19.

12. The amending standard establishes some new disclosure requirements and amends some existing disclosure requirements. We plan to develop a domestic ED to seek feedback on proposed new RDR concessions.

13. The Australian Accounting Standards Board (AASB) is expected to approve an amending standard based on *Amendments to Classification and Measurement of Financial Instruments* in the near future.

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[2] A summary of the IASB's February 2024 meeting is available at: [IFRS - IASB Update February 2024]

14. In 2020 the AASB issued a stand-alone disclosure standard, AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities*. Prior to this New Zealand and Australia had equivalent RDR regimes and New Zealand's Tier 1 and Tier 2 for-profit reporting requirements were aligned with those in Australia. The AASB now considers whether to add new disclosure requirements to AASB 1060 on a case by case basis. The AASB is expected to consider the effect of *Amendments to Classification and Measurement of Financial Instruments* on AASB 1060 in XXX 2024.

15. The issue of this amending standard is consistent with all three elements of the Financial Reporting Strategy: it adopts the international standard, retains a harmonised position with Australia for Tier 1 for-profit entities and is consistent with the Accounting Standards Framework.

Commencement and application date

16. The commencement and application date requirements for the amending standard is included in Appendix A of this memo. An entity that is not an early adopter is required to apply the amending standard for accounting periods beginning on or after 1 January 2026. Application is permitted for an 'early adoption accounting period' when that period begins before the mandatory date but has not ended or does not end before this amending standard takes effect (as defined in Appendix A).

Other matters

17. There are no other matters relating to the issue of this amending standard that the NZASB considers to be pertinent or that should be drawn to your attention.

Recommendation

18. The NZASB recommends that you sign the attached approval certificate and certificate of determination on behalf of the External Reporting Board.

Attachments

Amendments to the Classification and Measurement of Financial Instruments

Approval certificate

Certificate of determination

Carolyn Cordery
Chair NZASB

Appendix A: Commencement and application

A1. The commencement and application provisions below will apply to the amending standard once it is published.

When standard takes effect (section 27 Financial Reporting Act 2013)

A2. This standard takes effect on the 28th day after the date of its publication under the Legislation Act 2019. The standard is expected to be published on XX June 2024 and take effect on XX July 2024.

Accounting periods in relation to which standards commence to apply (section 28 Financial Reporting Act 2013)

A3. The accounting periods in relation to which this standard commences to apply are:

(a) for an early adopter, those accounting periods following, and including, the early adoption accounting period; and

(b) for any other reporting entity, those accounting periods following, and including, the first accounting period for the entity that begins on or after the mandatory date.

A4. In applying paragraph A3:

early adopter means a reporting entity that applies the standard for an early adoption accounting period.

early adoption accounting period means an accounting period of the early adopter:

(a) that begins before the mandatory date but has not ended or does not end before this standard takes effect (and to avoid doubt, that period may have begun before this standard takes effect); and

(b) for which the early adopter:

(i) first applies this standard in preparing its financial statements; and

(ii) discloses in its financial statements for that accounting period that the standard has been applied for that period.

mandatory date means 1 January 2026.