Global IFRS Specialist Group

Treatment of financial assets that are debt instruments under IFRS 9 ‘Financial Instruments’

Definition

The term ‘financial asset’ is defined in IAS 32, paragraph 11 as any asset that is:

a) cash;

b) an equity instrument of another entity;

c) a contractual right:
   - i. to receive cash or another financial asset from another entity; or
   - ii. to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or

d) a contract that will or may be settled in the entity’s own equity instruments and is:
   - i. a non-derivative for which the entity is or may be obliged to received a variable number of the entity’s own equity instruments; or
   - ii. a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity’s own equity instruments. For this purpose the entity’s own equity instruments do not include puttable financial instruments classified as equity instruments in accordance with IAS 32, paragraphs 16A and 16B, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with IAS 32, paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the entity’s own equity instruments.

Produced by the Global IFRS Specialist Group

Our Global IFRS specialists have the benefit of continuing day-to-day experience in IFRS. This means that we can bring practical knowledge to IFRS questions raised and help to apply the sometimes complex regulations in a way that minimises the risk of audit adjustments or the detection of accounting errors by national regulators.

Wherever your clients are doing business, let our Global IFRS Specialists be your outsourced team.

Classification

Under IFRS 9 financial assets that are debt instruments are classified into the following categories:

- amortised cost;
- fair value through other comprehensive income (‘FVOCI’); or
- fair value through profit or loss (‘FVTPL’)

The above classification is determined based upon two tests:

- the entity's business model for managing the financial assets ('the business model test'); and
- the contractual cash flow characteristics of the financial asset ('the contractual cash flow characteristic's test)

The tests can be summarised as follows:

	Business model	Contractual cash flow
Amortised cost	To hold financial assets in order to collect contractual cash flows	Contractual cash flows on specified dates that are solely payments of principal and interest ('SPPI')
FVOCI	To collect contractual cash flows and sell financial assets	Contractual cash flows on specified dates that are solely payments of principal and interest ('SPPI')
FVTPL	If not measured at amortised cost or FVOCI as above	

Exception

Paragraph 4.1.5 of the standard gives preparers of financial statements the option to irrevocably designate a financial asset as measured at fair value through profit or loss at initial recognition if doing so eliminates or significantly reduces a measurement or recognition inconsistency (an 'accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases.

Examples

The following table sets out the usual classification of certain common financial assets:

Amortised cost	▪ Trade receivables ▪ Loan receivables with 'basic' features, including intercompany loans ▪ Investments in plain vanilla corporate or government bonds not held for trading ▪ Investments in term deposits at standard interest rates
FVOCI	▪ Bonds held for both the collection of contractual cash flows and for sale to meet day to day liquidity needs
FVTPL	▪ Profit participating loans ▪ Convertible bonds ▪ Contingent consideration from business sale

Accounting

The accounting for financial assets that are debt instruments can be summarised as follows:

Amortised cost

The asset is recognised initially at fair value. Subsequently interest income is calculated using the effective interest method and recognised in profit or loss, together with impairment gains and losses calculated using the expected credit loss model. Gains or losses on derecognition are recognised in profit or loss.

FVOCI

The asset is initially recognised at fair value. Subsequently gains and losses are recognised in other comprehensive income, except for impairment gains or losses (calculated using the expected credit loss model) and foreign exchange gains and losses. On derecognition, the cumulative gain or loss previously recognised in OCI is reclassified to profit or loss.

Interest calculated using the effective interest method, impairment gains and losses and a portion of foreign exchange gains and losses are recognised in profit or loss such that the profit or loss impact of a financial asset measured at FVOCI is the same as if it were measured at amortised cost.

FVTPL

The asset is initially recognised at fair value. Subsequent change in fair value are recognised in profit or loss as they arise.

For more information contact IFRS Specialists:

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