NZ ACCOUNTING STANDARDS BOARD

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Board Meeting Agenda

Wednesday 20 March 2019
External Reporting Board, Level 7, 50 Manners Street, Wellington

Est Time	Item	Topic	Objective		Page
B: PUBLIC SESSION					
PBE Item for Consideration					
10.45 am	**4**	**PBE IPSAS 40 *PBE Combinations***	(ALH)		
	4.1	Cover memo	Consider	Paper	
	4.2	Submissions received			
	4.2.1	PwC	Consider	Paper	
	4.2.2	BDO	Consider	Paper	
	4.2.3	Auckland Council	Consider	Paper	
	4.2.4	Audit NZ	Consider	Paper	
	4.3	ITC ED PBE IPSAS 40	Note	Supp paper	
	4.4	ED PBE IPSAS 40	Note	Supp paper	
	4.5	ED PBE IPSAS 40 – marked-up	Note	Supp paper	
D: PUBLIC SESSION					
PBE Item for Approval					
1.00 pm	**6**	**PBE IPSAS 41 *Financial Instruments***	(JS)		
	6.1	Cover memo	Consider	Paper	
	6.2	Submissions received			
	6.2.1	PwC	Consider	Paper	
	6.2.2	Auckland Council	Consider	Paper	
	6.2.3	Audit NZ	Consider	Paper	
	6.3	Draft PBE IPSAS 41 *Financial Instruments*	Approve	Paper	
	6.4	Draft *Effective Date of PBE IFRS 9*	Approve	Paper	
	6.5	Signing memo	Approve	Paper	
PBE Items for Consideration					
1.45 pm	**7**	**PBE Policy Approach**	(TC)		
	7.1	Cover memo: Annual review of the application of the PBE Policy Approach	Note	Paper	
	7.2	*Policy Approach to Developing the Suite of PBE Standards*	Note	PBE Policy Approach	Hyperlink to doc

Est Time	Item	Topic	Objective		Page
2.00 pm	**8**	**IPSASB ED 67 *Collective and Individual Services and Emergency Relief***	(ALH)		
	8.1	Cover memo	Note	Paper	
	8.2	Draft comment letter	Consider	Paper	
	8.3	ED 67	Consider	Paper	
	8.4	At a Glance ED 67	Note	Supp paper	
	8.5	IPSAS 42 *Social Benefits*	Note	Supp paper	
	8.6	Comment letter on ED 63 *Social Benefits*	Note	Supp paper	
	8.7	Comment letter on Consultation Paper *Accounting for Revenue and Non-Exchange Expenses*	Note	Supp paper	
	8.8	Treasury's Guidance on *Recognising Liabilities and Expenses*	Note	Supp paper	
3.00 pm		*Afternoon tea*			
PBE Item for Approval					
3.15 pm	**9**	***Uncertainty over Income Tax Treatments* (Amendments to PBE IAS 12)**	(GS)		
	9.1	Cover memo	Note	Paper	
	9.2	Draft ITC	Approve	Paper	
	9.3	Draft ED	Approve	Paper	

Next NZASB meeting: Thursday 2 May 2019

NZ ACCOUNTING STANDARDS BOARD

Memorandum

Date:	8 March 2019
To:	NZASB Members
From:	Aimy Luu Huynh
Subject:	PBE Combinations

Recommendations

1. We recommend that the Board:

   (a) CONSIDERS the submissions received on NZASB ED 2018-4 PBE IPSAS 40 *PBE Combinations* (the ED);

   (b) AGREES the proposed changes to the draft standard in response to comments received; and

   (c) NOTES the next steps of this project.

Structure of this memo

2. This memo is structured as follows:

   (a) Background;

   (b) Submissions received;

   (c) Overview of the feedback received;

   (d) Analysis of feedback received; and

   (e) Next steps.

3. This memo identifies matters raised by respondents to the ED and members of the Technical Reference Group (TRG), and outlines the changes we propose in response to the feedback received. We will draft the changes to the proposed standard after the Board meeting.

4. In order to see the respondents' comments in context please refer to the submissions themselves (see agenda items 4.2.1 to 4.2.4).

Background

5. The Board issued the ED in September 2018. Comments were due by 31 January 2019. The Invitation to Comment (ITC) and EDs (clean and marked-up) have been included in the agenda as supporting papers (see agenda items 4.3 to 4.5).

6. As explained in the ITC, the ED is based on IPSAS 40 *Public Sector Combinations* and would supersede PBE IFRS 3 *Business Combinations*, the current PBE Standard. Although the acquisition requirements in IPSAS 40 are based on IFRS 3 *Business Combinations* and are therefore similar to the current requirements in PBE IFRS 3, the amalgamation requirements were developed by the IPSASB to meet the need for guidance on amalgamations in the public sector.

7. The Board considered the relevance of IPSAS 40's requirements for New Zealand PBEs and proposed a number of changes. The reasons for the changes are discussed in the ITC.

8. Staff carried out the following outreach activities.

   (a) Presented to the Chartered Accountants Australia and New Zealand (CA ANZ) not-for-profit (NFP) special interest group in Wellington and the Experienced Finance Professionals[1] (EFP) forum for the state sector.

   (b) Published a notice on the EFP forum intranet.

   (c) Sought feedback from the TRG.

   (d) Met with Charities Services and a notice about the ED was put on the Charities Services' website.

   (e) Notified the Office of the Auditor-General and the New Zealand Society of Local Government Managers so they could inform their networks.

   (f) Hosted an XRB webinar.

Submissions received

9. We received four submissions, as listed below.

R#	Respondent	Type	Agenda item
R1	PwC	CA firm	4.2.1
R2	BDO	CA firm	4.2.2
R3	Auckland Council	Public sector	4.2.3
R4	Audit NZ	CA firm	4.2.4

Overview of the feedback received

TRG

10. We sought feedback from the TRG on the proposed approach for classifying a combination as an amalgamation or an acquisition.[2] TRG members supported the proposed approach for

[1] This is a forum organised by Treasury for finance professionals in the state sector to share knowledge of relevant topics

[2] This TRG feedback was reported to the Board in December 2018 (as agenda item 13.6).

classification and thought the approach would lead to an appropriate classification of combinations.

11. One TRG member expressed concerns that the changes made to IPSAS 40 could lead to PBE Standards diverging from IPSAS. The member did not think the proposed changes were essential. The member would have preferred that the NFP modifications were in separate paragraphs. Despite the member's concerns, the member thought the proposed standard is still workable.

12. TRG members supported the proposed indicators relating to consideration and the decision-making process and noted that these indicators are used in practice in classifying a combination as an amalgamation or an acquisition.

13. TRG members provided feedback on some other points for consideration in finalising the standard. These points are included in the next section of this memo.

Respondents

14. Three respondents (R1, R2 and R3) are generally supportive of the proposals in the ED. These respondents provided recommendations for additional guidance or further discussion in the Basis for Conclusions (BCs) on the proposed changes to the underlying IPSAS 40.

15. R4 supported the Board issuing a standard on PBE Combinations and thought the approach taken by the IPSASB in IPSAS 40 would result in sensible accounting in the public sector. However, R4 has significant concerns about the extent of the changes to IPSAS 40. R4 disagrees or only partially agrees with four out of the 10 key changes to the ED.

16. Although one respondent disagrees with some of the key changes, all of the respondents supported the majority of the key changes. Staff believe that this should give the Board some comfort that the draft standard is heading in the right direction.

Analysis of feedback received

17. Table 1 summarises respondents' views on the questions in the ITC. We have classified responses as agree, partially agree and disagree. Although such classification involves judgement we think it gives an overall impression of the extent to which constituents support (or do not support) the proposals.

18. Table 2 identifies significant feedback received and the staff response. Table 2 focuses on matters on which respondents or the TRG disagree with the proposals or have made recommendations.

Table 1 Summary of responses

Question 1 Do you agree with the changes (as listed below) made by the NZASB in developing the proposed PBE IPSAS 40? If not, please explain why not and identify what you think would be more appropriate.	
(a) Indicators relating to consideration	TRG Agree – a matter for clarification and some concerns about divergence (crossover with and addressed in question 6) R1 Partially agree – recommend more guidance R2 Agree R3 Agree R4 Disagree – see comments
(b) Definitions of equity interests and owners	R1 Agree R2 Agree R3 Agree R4 Agree
(c) Use of the term "new entity"	R1 Agree R2 Agree – recommend replacing a diagram R3 Agree R4 Agree
(d) Applying the modified pooling of interests method	R1 Disagree – see comments (or revise BC) R2 Agree – recommend adding a diagram R3 Agree R4 Disagree – see comments
(e) Presentation of financial statements and disclosures	TRG A matter for clarification R1 Agree R2 Agree R3 Agree R4 Agree
(f) Acquiring a non-cash-generating operation	R1 Agree – add additional example and expand BC R2 Agree R3 Agree – see explanatory comments and request for additional definitions R4 Disagree – see comments
(g) Identifying an acquirer	R1 Agree R2 Agree R3 Agree R4 Partially agree – see comments
(h) Transition	R1 Agree – clarify paragraph AG50.2(c) (crossover with question 1(j)) R2 Agree R3 Agree R4 Agree
(i) Voluntary combination not under common control	R1 Agree R2 Agree R3 Agree R4 Agree
(j) Selection of accounting policies by the resulting entity	R1 Agree – clarify paragraph AG50.2 R2 Agree R3 Agree R4 Agree

Question 1 Do you agree with the changes (as listed below) made by the NZASB in developing the proposed PBE IPSAS 40? If not, please explain why not and identify what you think would be more appropriate.	
(k) Income taxes	R1 Agree R2 Agree R3 Agree R4 Agree – editorial comment
Question 2 Do you agree with the changes (as listed in Table 2) made by the NZASB in developing the proposed PBE IPSAS 40? If not, please explain why not and identify what you think would be more appropriate.	
R1 Agree R2 Agree R3 Agree R4 Disagree with many changes – see comments	
Question 3 Do you agree with retaining paragraphs 13(b) and AG36 in the proposed PBE IPSAS 40? If you disagree, please provide reasons.	
R1 Agree R2 Agree R3 Agree R4 Agree	
Question 4 Do you agree with the concessions and associated RDR paragraphs in the proposed PBE IPSAS 40? If you disagree, please provide reasons and indicate any additional concessions or RDR paragraphs that you consider would be appropriate.	
R1 Agree R2 Agree R3 Agree R4 Agree	
Question 5 Do you agree with the proposed effective date of 1 January 2021, with early adoption permitted? If you disagree, please provide reasons.	
R1 Agree R2 Agree R3 Agree – see comment about documenting differences with IPSAS 40 R4 Agree	
Question 6 Do you have any other comments on the Exposure Draft?	
TRG Yes – a matter for clarification and some concerns with divergence R1 Yes – editorial comment R2 No R3 No R4 Yes – see comment about the PBE Policy Approach	

19. At the meeting we plan to work through the comments in Table 2 and check that the Board agrees with the proposed staff response. If the Board does not agree with the proposed staff response we will seek direction as to the Board's preferred response. The background to each of these issues is set out in the ITC (agenda item 4.3 of the supporting papers). If you need to refer to the text of the underlying requirements in IPSAS 40 this is available in the marked-up copy of the ED (agenda item 4.5 in the supporting papers).

Table 2 Comments and staff response

Q1(a) Indicators relating to consideration		
R#	**Comments**	**Staff response**
TRG	A TRG member thinks the ED may not have sufficient guidance on payments that are not consideration.	Paragraph AG28 of the ED has an example of reimbursement of cost to the seller for expenses incurred in effecting the combination. Scenario 6 of the ED illustrates the acquirer reimbursing the acquired operation for the cost of transferring the title of assets and liabilities. We think there is sufficient guidance on payments that are not consideration. We propose no changes to the draft standard.
R1	The respondent recommends providing application guidance on how the extent of consideration payable may affect the assessment of whether a combination is an amalgamation instead of suggesting that only the absence of consideration paid to compensate those with an entitlement to the net assets of the transferred operation may provide evidence that the combination is an amalgamation. The respondent notes that in practice consideration set at an amount equal to the fair value of the combining operation may provide evidence that the combination is an acquisition. Conversely, if the consideration is set at an amount equal to the existing book values of the combining operation, it may provide evidence that the combination is an amalgamation.	Staff consider that the requirements in paragraph 12, guidance in paragraphs AG26–AG30 and scenario 7 paragraph IE79 (about the possibility of no consideration reflecting fair value) along with the other requirements and guidance provide sufficient guidance to assess whether the economic substance of the combination is an amalgamation or an acquisition. We propose no changes to the draft standard.
R4	The respondent disagrees with the proposed changes to the indicators relating to consideration. The respondent is of the view that the underlying requirements in IPSAS 40 are clear and workable for the public sector. The respondent is concerned with the proposed reclassification of scenario 6 in the illustrative examples from an amalgamation to an	We note the respondent's concern. This was one of the major issues considered by the Board in developing the ED. The Board spent a lot time on this matter and has carefully considered the changes and the implications for combinations in New Zealand. The Board has provided its reasons for the changes to the indicators

Q1(a) Indicators relating to consideration		
R#	**Comments**	**Staff response**
	acquisition. The respondent notes the changes could result in a substantive divergence from IPSAS. The respondent considers the Board's desire to allow for the possibility that a donated operation could be an acquisition is already addressed in IPSAS 40 – paragraphs AG30 (reasons for no consideration) and AG29 (example that a bequest of an operation may be an acquisition). The respondent thinks the Board's concerns about the possibility of a donated operation being an acquisition could be addressed by adding another specific example from an NFP context. Rather than changing the classification of scenario 6, the respondent thinks the Board could expand the analysis to include further assessment of the reasons for no consideration and possibly the assessment of additional matters such as meeting the objectives of financial reporting and satisfying the qualitative characteristics. The respondent considers that a conclusion of either an amalgamation or acquisition depending on the specific circumstances could be appropriate for this scenario.	relating to consideration in paragraphs 19–23 of the ITC and BC4-BC8 of the ED. We propose no changes to the draft standard.

Question for the Board

Q1. Does the Board agree with staff's response to address the comments received on indicators relating to consideration?

Q1(c) Use of the term "new entity"		
R#	**Comments**	**Staff response**
R2	The respondent recommends replacing the diagram in IG2 of the ED with Diagram 1 from page 13 of the ITC. The respondent considers that Diagram 1 clearly distinguishes between new entity and continuing entity and is more consistent with the proposed changes in the ED.	We agree with R2's comments. The Board introduced the term new *reporting* entity and *continuing reporting entity* because there was inconsistency and lack of clarity in the use of the term new entity in IPSAS 40. We propose to replace the diagram in IG2 with Diagram 1 from the ITC. We will include appropriate paragraph references in the diagram.

Question for the Board
Q2. Does the Board agree with the proposed changes to the draft standard to address the comments received on use of the term "new entity"?

Q1(d) Applying the modified pooling of interests method		
R#	**Comments**	**Staff response**
R1	The respondent notes that where a combining operation has previously been acquired in an acquisition the carrying amounts of the combining operation's assets and liabilities in its separate financial statements may be different to the carrying amounts of those assets and liabilities in the controlling operation's consolidated financial statements as a result of adjustments made in the acquisition accounting by the controlling operation. The respondent reads the ED as proposing that, where such are amalgamated, the carrying amounts used in accounting for the amalgamation should be the carrying amounts in the financial statements of the combining operations rather than the carrying amounts in the controlling entity's consolidated financial statements. The respondent notes that it is common for the amalgamation to be accounted for using the carrying amounts of assets and liabilities of the controlling operation from the consolidated financial statements of the highest operation that has common control for which consolidated financial statements are prepared. The respondent notes that the proposals in the ED may cause a change in practice where a controlled operation is amalgamated into a controlling operation. If the Board decides to proceed with the proposals in the ED, the respondent suggests adding a BC paragraph outlining the Board's reason for this requirement.	The ED was not intended to change current practice in the way envisaged by the respondent. In considering the feedback received we propose to clarify this in the draft standard. The ED is proposing to delete the last sentence in paragraph AG54 (shown below). That sentence assumed the controlling operation is not one of the combining operations. If the controlling operation is one of the combining operations, then the resulting entity would recognise the carrying amounts in the controlling operation's consolidated accounts. This is consistent with paragraph AG60 (shown below). AG54. To meet the requirements in paragraphs 26–27, a resulting entity measures the assets and liabilities of the combining operations at their carrying amounts in the financial statements of the combining operations as of the amalgamation date, subject to the requirement to adjust the carrying amounts to conform to the resulting entity's accounting policies. ~~The resulting entity does not measure the assets and liabilities at the carrying amounts in the financial statements of the controlling entity~~ AG60. Where a combining operation has previously recognised goodwill as a result of a previous acquisition, the resulting entity recognises this goodwill in its opening statement of financial position. We propose to add clarification and a BC on the accounting for a combining operation that was previously a controlled operation and continue to propose that the last sentence of paragraph AG54 be deleted.

Q1(d) Applying the modified pooling of interests method		
R#	**Comments**	**Staff response**
R2	The respondent recommends including Diagram 2 from page 14 of the ITC under paragraphs AG50.1 and AG50.2 of the proposed standard as this diagrammatical summary of the requirements would be useful for users.	We agree Diagram 2 is a good summary and propose to include a modified version of Diagram 2 in the draft standard. We think the diagram should be less detailed than Diagram 2 and include more references to the relevant AG paragraphs.
R4	The respondent disagrees with the changes to paragraphs 21 and 23 of the ED. The respondent thinks the guidance about restructuring costs following an amalgamation in paragraph 23 is useful and is unclear why it has been deleted. The respondent thinks limiting the recognition of assets and liabilities to those previously recognised by combining operations (as per the original paragraph 21 of IPSAS 40) is sensible. The respondent is of the view that the Board's changes to permit the recognition of previously unrecognised assets and liabilities should be made clearer and to provide examples of assets and liabilities that could be recognised under the ED which could not be recognised under IPSAS 40. The respondent thinks the Board's concern about entities previously applying Tier 3 or Tier 4 PBE Accounting Requirements could have been dealt in a different way but did not identify an alternative approach.	Paragraph 16(c) of the ED is the overriding requirement in that the resulting entity shall recognise and measure assets and liabilities in accordance with the PBE Standards. If we retained paragraph 23 (recognition of assets and liabilities in accordance with the Conceptual Framework) this would have created inconsistency between the ED and PBE FRS 47 *First-time Adoption of PBE Standards by Entities Other Than Those Previously Applying NZ IFRS.* PBE FRS 47 may result in the recognition of assets and liabilities as at the date of amalgamation that were not previously recognised by the first-time adopter. We propose no changes to the draft standard.
R4	The respondent suggests paragraph AG50.2(c) should be amended to refer to the accounting policies of the new reporting entity, as it is possible that the combining operations previously had inconsistent accounting policies. This change would also be consistent with the requirement in paragraph 27 of the ED.	Paragraph AG54.1 provides guidance for the new reporting entity and the combining operations where they have applied different accounting policies. We propose no changes to the draft standard.

Question for the Board

Q3. Does the Board agree with staff's response and the proposed changes to the draft standard to address the comments received on applying the modified pooling of interests method?

Q1(e) Presentation of financial statements and disclosures		
R#	**Comments**	**Staff response**
TRG	A TRG member queried whether combined comparative information could be presented as a single column on the face of the financial statements and noted that this form of presentation had previously been used for the merger of two public sector entities.	Paragraph 50 of the ED specifies that a new reporting entity shall not present comparative information on the face of its financial statements. The resulting entity is permitted to disclose comparative information for the combining operations in the notes. The sub-Board considered permitting pro-forma comparative information (as if the two entities had been one entity in the prior period) to be presented but was concerned that this would imply that the operations have always been combined. The sub-Board wanted to avoid any doubt about when the combination occurred – the ED therefore required that combining operations' prior period information be provided in the notes. If the Board wished, we could expand paragraph BC23 to mention why comparatives on the face are not permitted. We propose to explain (in paragraph BC23) why the reason the Board has not permitted presentation of combined comparatives on the face of the financial statements.

Question for the Board

Q4. Does the Board agree with the proposed changes to the draft standard to address the comments received on presentation of financial statements and disclosures?

<table>
<tr><td colspan="3">Q1(f) Acquiring a non-cash-generating operation</td></tr>
<tr><td>R#</td><td>Comments</td><td>Staff response</td></tr>
<tr><td>R1</td><td>The respondent recommends the BC be expanded to discuss more fully the reasons for the Board’s decision to require goodwill arising on an acquisition of a non-cash generating operation to be expensed. The respondent thinks this may facilitate greater appreciation of the difficulties and cost the Board had envisaged when it suggested the practical option of expensing the goodwill. In the absence of a fuller explanation the Board’s proposal could appear to be an unnecessarily extreme approach.</td><td>BC26 of the ED notes the Board’s concern about the practical workability of the requirements for impairment testing. We could expand the discussion of practical workability to identify some of the costs and difficulties envisaged by the Board. This would be consistent with R3’s comments (see below) about goodwill impairment testing being time consuming and costly.
We propose to expand paragraph BC26 of the draft standard to address respondents’ comments.</td></tr>
<tr><td>R1</td><td>The respondent notes that a combining operation may consist of more than one operation, one of which may be cash generating and the other non-cash generating. The proposals in the ED may require a break down of the combining operation into its cash-generating and non-cash generating operations to effect the appropriate acquisition accounting. Preparers may not be aware that the potential unit of account for an acquisition is at a lower level than the combined operation.
The respondent recommends providing an example of accounting for a combination where the combined operation contains both cash-generating and non-cash-generating operations.</td><td>Paragraph AG93 of the ED notes that goodwill is not recognised if the goodwill relates to the acquisition of a non-cash generating operation. This would suggest that the acquirer would need to assess whether the acquired operation is a cash-generating or non-cash-generating operation. Paragraph AG93 is shown below.
<blockquote>The acquirer shall recognise goodwill only to the extent that the acquirer estimates there will be favourable changes to its net cash flows, either from increased cash inflows or decreased cash outflows, and the goodwill relates to the acquisition of a cash-generating operation. An acquirer shall not recognise goodwill related to service potential other than cash flows nor goodwill related to the acquisition of a non-cash-generating operation.</blockquote>We propose no changes to the draft standard because there seems to be sufficient guidance in paragraph AG93 to suggest that the acquirer would need to assess whether the acquired operation is a cash-generating or non-cash-generating operation.</td></tr>
</table>

Q1(f) Acquiring a non-cash-generating operation		
R#	**Comments**	**Staff response**
R3	The respondent agrees with the proposed changes in the ED as it addresses issues that it has experienced as a large mixed group. The respondent notes the following concerns with recognising goodwill acquired in acquisition of a non-cash generating operation. • Paying a significant premium to acquire an operation is likely to lead to increased public scrutiny, concerns around probity and integrity of the spend. • Goodwill impairment testing is time consuming and costly.	We note R3's comments. Goodwill impairment testing being time consuming and costly supports the Board's view about the practical workability of the impairment requirements in IPSAS 26 *Impairment of Cash-Generating Assets.*
R3	The respondent suggests adding definitions for cash-generating operation and non-cash-generating operation. The PBE Standards only have definitions for cash-generating asset and cash-generating units.	The ED has a definition of operation. We don't think definitions of cash-generating operation and non-cash-generating operation are essential but agree it could be helpful. We could suggest this to the IPSASB as these are new terms introduced in IPSAS 40. The IPSASB could include this in its next improvements project. We propose suggesting to the IPSASB that it adds definitions for cash-generating operation and non-cash-generating operation.
R4	The respondent disagrees with the proposed amendments to the ED and PBE IPSAS 26 *Impairment of Cash-Generating Assets.* The respondent thinks a better option would be to allocate the goodwill to the cash-generating units that are expected to benefit from the combination, this is inline with the existing requirements in PBE IPSAS 26.90.1.	In developing the proposal to expense the goodwill acquired in an acquisition of a non-cash generating operation staff had consulted with some public sector constituents and they thought the subsequent impairment testing (as required in IPSAS 26) would not work. R2 and R3 supports the proposals in the ED. And R1 broadly supports the proposals subject to further discussion in the BC. We propose no changes to the draft standard.

Question for the Board

Q5. Does the Board agree with staff's response and the proposed changes to the draft standard to address the comments received on acquiring a non-cash-generating operation?

Q1(g) Identifying an acquirer		
R#	**Comments**	**Staff response**
R4	Paragraph AG14 is not about identifying an acquirer; it is about identifying whether one entity has gained control over another. The respondent suggests that the term "acquirer" is changed as it implies acquisition, whereas the guidance in AG14 can be relevant to combinations that are either amalgamations or acquisitions.	We agree with R4's point. We propose to replace acquirer with "the entity that gains control" in paragraph AG14. This is a neutral term that could be for either amalgamations or acquisitions.
R4	The respondent disagrees with the amendments made to paragraph AG17. The respondent thinks the wording in IPSAS 40 was clearer than the wording in the ED. The respondent does not consider any amendment is required to paragraph AG17 to address B15(c) and (d) of PBE IFRS 3 *Business Combinations*.	The Board did not think the original paragraph AG17 was sufficiently clear and proposed amendments to clarify this, also the amendments would be consistent with the guidance in paragraph AG14 about identifying the party that gains control. We propose no changes to the draft standard.

Question for the Board

Q6. Does the Board agree with staff's response and the proposed changes to the draft standard to address the comments received on identifying an acquirer?

Q1(h) Transition		
R#	**Comments**	**Staff response**
R1	Some new reporting entities may be a different (higher) tier than that of the combining operations. Paragraph AG50.2(c) of the ED suggests that the new reporting entity should still apply the accounting policies applied by any of the combining operations that applied PBE Standards prior to the amalgamation even if they reported in accordance with a different tier to that in which the new reporting entity falls. The respondent suggests clarifying that new reporting entities shall use the same accounting policies as those applied by the combining operations that applied PBE Standards prior to the amalgamation unless a change in accounting policy is required to comply with the requirements of the tier in which the new reporting entity falls.	This is an example where two Tier 2 combining operations amalgamate and become a Tier 1 new reporting entity. The combining operations would have been applying Tier 2 PBE Accounting Requirements. These standards are the same as the Tier 1 PBE Accounting Requirements but with reduced disclosures. There is no difference in recognition and measurement and thus it should not affect the accounting policies of the new reporting entity. We proposed no changes to the draft standard.

Question for the Board

Q7. Does the Board agree with staff's response to address the comments received on transition?

Q1(k) Income taxes		
R#	**Comments**	**Staff response**
R4	The respondent notes that the heading above paragraph 78 is "Income taxes (where included in the terms of acquisition)". The new paragraphs 79.1 and 79.2 apply whether or not tax is covered in the terms of acquisition, so may need a separate heading.	We agree with R4's comment. The description "where included in the terms of acquisition" relates to the original paragraph 78 of IPSAS 40 where the tax forgiven is part of the terms of the acquisition. The IPSASB does not have an equivalent standard for IAS 12 *Income Taxes*. We have carried forward all the relevant requirements relating to income taxes from PBE IFRS 3 and these being paragraphs 79.1 and 79.2 of the ED. We propose to remove the description "where included in the terms of acquisition" from the heading above paragraphs 78 and AG85 of the draft standard.

Question for the Board

Q8. Does the Board agree with the proposed changes to the draft standard to address the comments on income taxes?

Q2 Other changes		
R#	**Comments**	**Staff response**
R4	<u>Paragraphs 16(c), 21, 26, 28, 30, 41, 42, AG54, IE166, IE173, IE174 (reference to identifiable assets)</u> The respondent disagrees with removing the reference to identifiable assets in the guidance for amalgamations. The respondent does not support this change unless there is a clear explanation in the BCs explaining why the change has been made and the consequences (if any) of it. The respondent finds it unclear from the ED what deleting the term "identifiable" for amalgamations and retaining it for acquisitions is intended to achieve. If the intention of the proposal is that amalgamations can recognise some non-identifiable assets that cannot be directly recognised in an acquisition, then this should be made clearer. An example of this type of transaction is the treatment of goodwill previously recognised by a combining operation in an amalgamation (although this is covered by AG60).	In addition to the comments in the ITC, we have amended IPSAS 40 by bringing in the first-time adoption of PBE Standards requirements which permits the recognition of assets and liabilities which may not been previously recognised. We propose to add a BC to explain the reason for removing reference to identifiable assets in the guidance for amalgamations.

Q2 Other changes		
R#	**Comments**	**Staff response**
R4	<u>Paragraph 20 (determining the amalgamation date)</u> The respondent disagrees with the deletion and thinks the example is helpful and not elsewhere in paragraph 20.	In addition to the comments in the ITC the example is proposed for deletion because the date specified in legislation is not necessarily the date that control is obtained. The example proposed for deletion is provided below. For example, legislation or a written agreement may provide that the resulting entity obtains control of the assets and liabilities of the combining operations on a specified date. We propose no changes to the draft standard.
R4	<u>Paragraph 21 (recognition principle)</u> The respondent thinks the remaining editorial changes are not necessary. The respondent thinks it is unclear why the NZASB proposed to delete the phrase "…that are recognized in the financial statements *of the combining operation* [sic]…".	We are only proposing to delete "…that are recognised in the financial statements …" The proposed deletion of the phrase is to be consistent with the other changes made to include the first-time adoption of PBE Standards requirements where combining operations could be recognising assets and liabilities that were previously unrecognised. This change is discussed in paragraph 36 of the ITC and BC20 of the ED. We propose no changes to the draft standard.
R4	<u>Paragraph 39(b) (presentation of net assets/equity)</u> The respondent thinks the proposed clarification makes it less clear than the original IPSAS.	We are proposing the clarification because IPSAS 40 is not clear on the existing reserves and the requirements in paragraphs 37–38 (what to recognise in net assets/equity). We propose no changes to the draft standard.
R4	<u>Paragraph 87 (goodwill)</u> The respondent thinks that it is not clear that the IPSASB intended this paragraph to be limited to the circumstances in paragraphs 101 and 102 of the ED.	We are proposing the clarification because the original paragraph could result in the recognition of both goodwill and gain on bargain purchase for acquisitions where there is no consideration transferred. We propose no changes to the draft standard.

Q2 Other changes		
R#	**Comments**	**Staff response**
R4	Paragraph AG25 (economic substance) The respondent disagrees with removing paragraph AG25 because it is quite different from paragraph AG21.	Paragraph AG21 already says what to do if there is insufficient evidence to determine the economic substance of the combination and we did not think keeping paragraph AG25 would be helpful. We propose no changes to the draft standard.
R4	Paragraphs AG43, AG44, table in AG45 (additional matters to consider) The respondent thinks the sentence about future cash flows is relevant and useful guidance in some public sector circumstances.	This phrase implies that assets and liabilities recorded at fair value prior to the acquisition will reflect the market's expectations of the value of the cash flows associated with those assets and liabilities. Many PBEs have mostly non-cash-generating assets. Although such assets might be measured at fair value under PBE IPSAS 17 *Property, Plant and Equipment* this does not necessarily mean that the fair value represents the market's expectations of future cash flows. We propose no changes to the draft standard.
R4	Paragraph AG53 (carrying amounts to be used) The respondent agrees that the sentence is not important but did not consider the reason provided warranted the removal of paragraph AG53.	We found it difficult to understand this paragraph and thought it could create confusion if it was retained. We propose no changes to the draft standard.
R4	Paragraph AG54 (carrying amounts to be used) The respondent disagrees with the deletion because the sentence continues the discussion from paragraph AG53 and is technically correct. The respondent agrees that the wording could be improved.	The deletion of the last sentence in paragraph AG54 supports the deletion of paragraph AG53. We propose no changes to the draft standard.
R4	Paragraphs AG65 and AG113 (information required by a regulator) The respondent thinks the paragraphs are technically correct and there is no need to make this change from IPSAS 40.	These paragraphs do not seem to be necessary because a regulator always has the option to require additional information. We propose no changes to the draft standard.

Question for the Board
Q9. Does the Board agree with staff's response and the proposed changes to the draft standard to address the comments received on other changes made in developing the ED?

Q5 Proposed effective date of 1 January 2021		
R#	**Comments**	**Staff response**
R3	The respondent notes that the proposed standard deviates from IPSAS 40 in many areas and suggests that the Board provides a list of differences between PBE IPSAS 40 and IPSAS 40 upon issuance.	The Board has previously agreed to make available to constituents a table that identifies the differences between the proposed standard and IPSAS 40. We propose that this table of differences be made available when the final standard is issued.

Question for the Board
Q10. Does the Board agree with staff's response to address the comments received on the effective date?

Q6 Other comments		
R#	**Comments**	**Staff response**
TRG	A TRG member notes that it may not be clear that the ED is for the combination of operations rather than combination of assets.	The ED defines an operation as "…an integrated set of activities and related assets and/or liabilities that is capable of being conducted and managed for the purpose of achieving an entity's objectives, by providing goods and/or services for community or social benefit, rather than a financial return to equity holders. In the context of this Standard, "operation" also includes an integrated set of activities that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants". The Board has recently issued *Definition of a Business* (Amendments to NZ IFRS 3). The amending standard clarifies the definition of a business and provides clearer application guidance to help entities distinguish between a business and a group of assets when applying NZ IFRS 3. The Board agreed to wait for the IPSASB to consider the amendments before

Q6 Other comments		
R#	**Comments**	**Staff response**
		deciding whether to incorporate these amendments into PBE Standards. We propose no changes to the draft standard and to continue to wait for the IPSASB to consider the amendments before deciding whether to incorporate these amendments into PBE Standards.
TRG	One TRG member has concerns with the changes made to IPSAS 40 because this could lead the PBE Standards to diverge from IPSAS. The member did not think the proposed changes are necessary. The member would have preferred that the NFP modifications be identified in separate paragraphs.	We note the member's concerns. Our response to this comment and R4's comment (next point) should be read together below. We don't tend to have separate paragraphs for NFP modifications unless the requirements are only applicable to the NFP entities. We will note any NFP modifications in the table of differences.
R4	The respondent is of the view that the Board has made too many changes to the core IPSAS. Some changes have improved the understandability or consistency but there are many changes that do not significantly improve the standard and are not necessary to be effective in the New Zealand environment. The respondent quotes the *Policy Approach to Developing the Suite of PBE Standards* (updated December 2018) (PBE Policy Approach) and thinks the proposed amendments do not meet the circumstances to amend an IPSAS as described in paragraph 24 of the PBE Policy Approach. The respondent supports the approach set out in the PBE Policy Approach but do not support the extensive changes the Board is proposing to the core IPSAS. New Zealand public sector entities assert that the PBE Standards are based on IPSAS and this leads to the respondent's concern that it would be hard to justify this if there are differences between the two suites of standards. The respondent thinks the BCs are incomplete as it does not contain the discussion on the other potentially substantive changes.	We note the respondent's concerns. The XRB Board and the Board agreed to make amendments to the PBE Policy Approach to: (a) clarify the process that the Board currently applies when considering developments to the suite of PBE Standards; and (b) allow flexibility to make substantive amendments to an IPSAS when it is not considered appropriate for New Zealand PBEs. The ITC and BC explains the issues the Board considered in developing the ED. We have tried to balance the core IPSAS and being clear and workable for the New Zealand context. We propose to provide further explanation/discussion in the BC for some of the changes we have noted above.
R4	The respondent is of the view that the substantive changes to the core IPSAS to be clearly identifiable in the PBE Standard.	We will make the table of differences between IPSAS 40 and the proposed standard available when the final

Q6 Other comments		
R#	**Comments**	**Staff response**
		standard is issued. The table will provide an outline of the changes made.

Question for the Board

Q11. Does the Board agree with staff's response and the proposed changes to the draft standard to address the other comments received on the ED?

Editorial changes		
R#	**Comment**	**Staff response**
R1	Paragraph AG 10 of the ED should read as follows: 'Where a party to a PBE combination gain<u>s</u> control~~s~~ of…'.	We agree with the editorial change. We propose to make the editorial change to paragraph AG10 of the draft standard. We will also let the IPSASB staff know so they can incorporate this in IPSAS 40.

Question for the Board

Q12. Does the Board agree with the editorial changes to paragraph AG 10 of the draft standard?

Next steps

20. We will update the draft standard and prepare the table of differences to reflect the Board's views on respondents' comments and the staff responses. We proposed that the updated standard and draft table of differences be reviewed by the sub-Board before seeking approval from the Board to issue.

21. We expect to seek approval to issue the standard later this year (possibility June 2019).

Attachments

Agenda Item 4.2	Submissions received	
	4.2.1	PwC
	4.2.2	BDO
	4.2.3	Auckland Council
	4.2.4	Audit NZ
Agenda Item 4.3	ITC ED PBE IPSAS 40 (in supporting documents)	
Agenda Item 4.4	ED PBE IPSAS 40 (in supporting documents)	
Agenda Item 4.5	ED PBE IPSAS 40 – marked-up (in supporting documents)	

Warren Allen
Chief Executive Officer
External Reporting Board
PO Box 11250
Manners St Central
Wellington 6142

25 January 2019

Exposure Draft NZASB 2018-4: PBE IPSAS 40 PBE Combinations

Dear Warren

The New Zealand Accounting Standards Board (NZASB) has sought comments on *Exposure Draft NZASB 2018-4: PBE IPSAS 40 PBE Combinations* (ED 2018-4). PwC New Zealand is pleased to present its comment letter.

We agree with the proposals in ED 2018-4 and the changes made by the NZASB in developing the proposed standard (for the reasons provided in the Invitation to Comment and the Basis for Conclusions supporting ED 2018-4). However, we do have some recommendations as set out below.

Indicators that a combination is an amalgamation

Regarding the indicators that provide evidence that a combination is an amalgamation, we recommend that the NZASB consider providing application guidance on how the extent of consideration payable may affect the assessment of whether a combination is an amalgamation instead of suggesting that only the absence of consideration paid to compensate those with an entitlement to the net assets of a transferred operation may provide evidence that the combination is an amalgamation.

For example, based on our experience in practice, consideration set at an amount equal to the fair value of the net assets of the combining operation may provide evidence that the combination is an acquisition. Conversely, if the consideration is set at an amount equal to the existing book values of the combining operation, it may provide evidence that the combination is an amalgamation.

Expensing of goodwill arising on the acquisition of a non-cash generating operation

We recommend that the NZASB provide, in the Basis for Conclusions, greater explanation of its decision to require that goodwill arising on the acquisition of non-cash generating operations be expensed immediately.

Addressing the difficulties and cost that the NZASB envisaged preparers may encounter and PBEs may incur in attempting to apply the approach adopted in IPSAS 41 *Public Sector Combinations* may enable greater understanding of the NZASB's considerations. This may facilitate greater appreciation for the practical option proposed by the NZASB of simply expensing this goodwill, which otherwise may appear to be an unnecessarily extreme approach.

Need to distinguish between cash and non-cash generating operations acquired

A combining entity may consist of more than one operation, one of which may be cash generating and the other non-cash generating (for example a public hospital with a private hospital wing where patients in the private wing pay market price for hospital services). In this scenario, based on our understanding of the proposed requirements, the PBE that obtains control of the combining entity may be required to break down a combining entity into its cash-generating and non-cash generating operations to effect the appropriate acquisition accounting (and immediately expense the goodwill arising in relation to the non-cash generating operation).

Preparers may not be fully aware that the potential unit of account for an acquisition is at a level lower than the combining entity. Particularly since, when accounting for acquisitions under PBE IFRS 3 *Business Combinations*, the acquisition accounting is applied at the level of the entity being acquired (rather than at a lower level such as at the level of the cash-generating units making up the entity).

To provide more clarity, we recommend that the NZASB provide an example of accounting for a combination with an entity that contains both cash-generating and non-cash generating operations.

Carrying amounts used in accounting for an amalgamation

Where a combining operation has previously been acquired in an acquisition the carrying amounts of the combining operation's assets and liabilities in its separate financial statements may be different to the carrying amounts of those assets and liabilities in the controlling entity's consolidated financial statements as a result of adjustments made in the acquisition accounting by the controlling entity.

ED 2018-4 proposes that, where these two entities are amalgamated, the carrying amounts used in accounting for the amalgamation should be the carrying amounts in the financial statements of the combining entities rather than the carrying amounts included in the controlling entity's consolidated financial statements.

However, in our experience, where such an amalgamation occurs between entities under common control, it is more common for the amalgamation to be accounted for using the carrying amounts of assets and liabilities of the acquired entity from the consolidated financial statements of the highest entity that has common control for which consolidated financial statements are prepared. These amounts include any goodwill and other fair value adjustments recorded at the consolidated level in respect of the acquired entity. This is because the transaction is under the control of that entity, and it is a portion of the controlling entity that is being moved within the group as a result of the transaction.

In particular, the proposal in ED 2018-4 that the carrying mounts used should be the carrying amounts in the financial statements of the combining entity may cause a noticeable change where a subsidiary is amalgamated into a parent. For example, a PBE parent may acquire company A and apply acquisition accounting thereby adjusting the assets and liabilities of company A to fair value. After the acquisition, the PBE parent's group financial statements would include the company A's assets and liabilities at fair value. In a subsequent period the PBE parent may decide to amalgamate company A's operations into the operations into that of the PBE parent. If the PBE parent accounted for the amalgamation using the carrying values of the company A's assets and liabilities included in the group financial statements the amalgamated entity could simply report the same carrying amounts that would have been reported in the PBE parent's consolidated financial statements.

If the PBE parent is required to use the carrying amounts in the financial statements of Company A, the amounts reported in the amalgamated entity's financial statements would not be comparable to the those previously reported in the PBE parent's group financial statements that would have included fair value adjustments on the acquisition of Company A.

Since the requirement to use the carrying amounts in the financial statements of the combining operations may be a change from practice in New Zealand, we suggest that the NZASB consider providing in its Basis for Conclusions rational for prescribing this approach.

Combining operations that have not previously applied PBE Standards

Where the entity resulting from a combination is a new reporting entity and one or more of the combining operations have not previously applied PBE Standards prior to the amalgamation, it is proposed that the resulting entity first apply XRB A1 *Application of the Accounting Standards* to determine the appropriate tier of reporting for the resulting new reporting entity.

Since the new reporting entity is an amalgamation of the combining operations and likely larger than any of the combining entities alone, it is possible that the tier in which the new reporting entity falls may be a different (higher) tier that that in which any of the combining entities fell. However, paragraph AG50.2(c) seems to suggest that the new reporting entity should still apply the policies applied by any of combining entities that applied PBE Standards prior to the amalgamation, even if they reported in accordance with a different tier to that in which the new reporting entity falls.

We recommend that paragraph AG50.2(c) be amended to clarify that the new reporting entity is required to apply the same accounting policies as those applied by any combining entities that applied PBE Standards prior to the amalgamation unless a change in policy is required to comply with the requirements of the tier in which the new reporting entity falls.

Editorial changes

We note that paragraph AG 10 of ED 2018-4 should read as follows: 'Where a party to a PBE combination gains controls~~s~~ of…'.

Should you wish to discuss the above, please do not hesitate to contact Richard Day on (09) 355 8824.

Yours sincerely

Jonathan Freeman
Partner
Assurance Leader

BDO NEW ZEALAND LIMITED
P O Box 2219
Auckland 1140

30 January 2019

Mr Warren Allen
The Chief Executive
External Reporting Board
PO Box 11250
Manners St Central
Wellington
6142

Dear Sir

Requests to comment on Exposure Draft ED NZASB 2018-4 *PBE IPSAS 40 PBE Combinations*

Thank you for the opportunity to comment on the above Exposure Draft.

We are making this submission to you to assist the New Zealand Accounting Standards Board (NZASB) with the above Exposure Draft. We are happy for you to publish our comments publically.

In responding we have addressed the specific questions for respondents in Appendix 1.

Overall we are supportive of the proposals contained in the Exposure Draft.

More information on BDO is provided in Appendix 2 to this letter.

We hope that our responses and comments are helpful. Should you wish to discuss any of the points we have raised please contact me (michael.rondel@bdo.co.nz) should you have any queries or require further information.

Yours faithfully,

BDO New Zealand
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Appendix 1 – Response to questions

Question	Response
Question 1 Do you agree with the changes (as listed below) made by the NZASB in developing the proposed PBE IPSAS 40? If not, please explain why not and identify what you think would be more appropriate. (a) Indicators relating to consideration (b) Definitions of equity interests and owners (c) Use of the term "new entity" (d) Applying the modified pooling of interests method (e) Presentation of financial statements and disclosures (f) Acquiring a non-cash-generating operation (g) Identifying an acquirer (h) Transition (i) Voluntary combination not under common control (j) Selection of accounting policies by the resulting entity (k) Income taxes	Yes, we agree with the listed proposed changes made by the NZASB in developing the proposed PBE IPSAS 40. In relation to 1(c), we would recommend that the NZASB substitute the diagram contained in paragraph 32 of the *Invitation to Comment* (Diagram 1) for the one that is currently contained in IG2, as the aforementioned diagram clearly distinguishes between "new entity" and "continuing entity" which is more consistent with the proposed changes being made. In relation to 1(d), we would recommend that the NZASB include the diagram contained in paragraph 36 of the *Invitation to Comment* (Diagram 2) under AG50.1 and AG 50.2 as this diagrammatical summary of the requirements is useful for users.
Question 2 Do you agree with the changes (as listed in Table 2) made by the NZASB in developing the proposed PBE IPSAS 40? If not, please explain why not and identify what you think would be more appropriate.	Yes, we agree with the changes listed in Table 2 made by the NZASB in developing the proposed PBE IPSAS 40.
Question 3 Do you agree with retaining paragraphs 13(b) and AG36 in the proposed PBE IPSAS 40? If you disagree, please provide reasons.	We do not believe that the example provided will be a common occurrence in New Zealand, but we have no concerns with retaining these paragraphs.
Question 4 Do you agree with the concessions and associated RDR paragraphs in the proposed PBE IPSAS 40? If you disagree, please provide reasons and indicate any additional concessions or RDR paragraphs that you consider would be appropriate.	Yes, we agree with the concessions and associated RDR paragraphs in the proposed PBE IPSAS 40.
Question 5 Do you agree with the proposed effective date of 1 January 2021, with early adoption	Yes, we agree with the proposed effective date of 1 January 2021, with early adoption permitted.

permitted? If you disagree, please provide reasons.	
Question 6 Do you have any other comments on the Exposure Draft?	We have no further comments.

Appendix 2 - Information on BDO

1. BDO New Zealand is a network of ten independently owned accounting practices, with fifteen offices located throughout New Zealand.

2. BDO firms in New Zealand offer a full range of accountancy services, including business advisory, audit, taxation, risk advisory, internal audit, corporate finance, forensic accounting and business recovery and insolvency.

3. BDO in New Zealand has 84 partners and over 800 staff.

4. BDO firms throughout New Zealand have a significant number of clients in the not-for-profit sector.

5. Five BDO firms in New Zealand (BDO Auckland, BDO Christchurch, BDO Northland, and BDO Wellington) are registered audit firms and thirteen audit partners are licensed auditors.

6. Internationally, BDO is the fifth largest full-service audit, tax and advisory firm in the world, with over 73,800 people in over 1,500 offices across over 162 countries and territories.

Auckland Council
Te Kaunihera o Tāmaki Makaurau

31 January 2019

Mr Warren Allen
Chief Executive
External Reporting Board
PO Box 11250
Manners St Central
Wellington 6142

Dear Warren

Auckland Council submission to NZASB ED 2018-4 PBE IPSAS 40 *PBE Combinations*

Thank you for the opportunity to comment on the exposure draft PBE IPSAS 40 *PBE Combinations.*

Auckland Council is Australasia's largest local government entity and is made up of the Council and six substantive council-controlled organisations. We invest heavily in infrastructure and many of our decisions will have a fiscal impact on Auckland's future generations. As Auckland Council is a "mixed group" (including profit-oriented and "not for profit entities") that provides a diverse range of services through entities which change in structure and ownership as the needs of the city change, this exposure draft is of specific interest to Auckland Council group.

Our responses to the specific questions for the respondents are included in Appendix 1 to this letter along with our additional comments for the XRB's consideration. In summary we are supportive of the changes made in developing the proposed PBE IPSAS 40.

We hope our responses and comments are helpful in aiding your decision-making process. Should you have any queries relating to the responses, please do not hesitate to contact Alvin Ang at the details provided below.

Yours sincerely

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Auckland Council
Te Kaunihera o Tāmaki Makaurau

Appendix 1 – Response to questions

1. Do you agree with the changes (as listed below) made by the NZASB in developing the proposed PBE IPSAS 40? If not, please explain why not and identify what you think would be more appropriate. (para 19 – 49)

   (a) Indicators relating to consideration (para 19 – 23)

   We agree with the amendments proposed by the NZASB to the indicators relating to consideration in PBE IPSAS 40 as they provide clearer guidance for preparers to correctly distinguish between an acquisition or amalgamation.

   (b) Definitions of equity interest and owners (para 24 – 25)

   We agree with the modification of definition of equity interests and owners. The phrase "equity interests" carries a broader scope to capture the different types of PBEs and residual interests in PBEs in New Zealand.

   (c) Use of the term "new entity" (para 26 – 33)

   We agree that the use of the term "new entity" in IPSAS 40 is unclear. The NZASB's revised paragraph 18 in the Standard provides a clear explanation of how to differentiate a "new reporting entity" and a "continuing reporting entity". We believe this will help to enhance the user's understanding.

   (d) Applying the modified pooling of interest method (para 34 – 36)

   We agree with the application of modified pooling of interest method. The existing PBE IFRS 3 does not contain sufficient guidance for combinations by way of a merger.

   The introduction of merger accounting via the modified pooling of interest method will provide public benefit entities an option that is fit for purpose when entering into combination arrangements in future.

   (e) Presentation of financial statements and disclosures (para 37 – 40)

   We agree with the NZASB to require the continuing entity to present comparative information in their first set of financial statements rather than allowing preparers the option to not present comparative information. This will ensure that consistency is maintained and readers of financial statements have a better understanding of the impact of the combination.

1. Do you agree with the changes (as listed below) made by the NZASB in developing the proposed PBE IPSAS 40? If not, please explain why not and identify what you think would be more appropriate. (para 19 – 49) (Continued)

   (f) Acquiring a non-cash generating operation (para 41 – 43)

   We concur with the inclusion of additional restrictions on the recognition of goodwill. Although Auckland Council's mandate is to provide services to the public on a non-profit basis, it also hold stakes in for-profit entities such as the Ports of Auckland and Auckland International Airports Limited. The ED addresses the issues we experience as a large mixed group as discussed below.

Conflict in producing a strong discounted cash flow that exceeds the carrying amount of goodwill

As defined by the Treasury, PBEs are reporting entities whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than a financial return to equity holders.

In a situation where a public entity acquires a cash-generating entity, any goodwill arising from the acquisition is required to be recognised to the statement of financial position by the Standard. Subsequently, the goodwill recognised will have to be tested for impairment annually as per the requirements of PBE IPSAS 26.

The operations of PBEs are expected to be configured in a way that delivers the highest level of service to the public which often comes at the expense of profits. Therefore, by default, management's focus will be on quality of service delivery rather than maximising profits to support the discounted cash flow model that will generate higher future cash flows to support the value in use ("VIU"). This creates a conflict for management to arrive at a higher VIU to support the carrying value of goodwill.

Relevance to non-cash generating operations

Goodwill is an asset representing the future economic benefits that are expected to arise from other assets acquired in an acquisition that are not individually identified and separately recognised. In other words, goodwill is a premium that an acquirer pays on top of the fair value of the acquiree. The willingness of buyer to pay above the fair value is largely driven by the reputation, management team or customer base of the acquiree.

In the for-profit context, having goodwill on the Statement of Financial Position usually signifies that the business has gained rights to acquiree's reputation, brand names, customer lists, a unique market position, knowledge of new technology, a good location, specialist skills or operating methods via acquisitions. The goodwill helps to attract funding from potential investors or higher profits from synergies achieved.

In the PBE context, it is unlikely that having goodwill on the Statement of Financial Position will provide benefits such as an increase in revenue or the attraction of additional external funding. In an unlikely event that the PBE pays a significant premium to acquire an operation, this is likely to lead to increased public scrutiny, concerns around probity and integrity of the spend.

1. Do you agree with the changes (as listed below) made by the NZASB in developing the proposed PBE IPSAS 40? If not, please explain why not and identify what you think would be more appropriate. (para 19 – 49) (Continued)

   (f) Acquiring a non-cash generating operation (para 41 – 43) (Continued)

   Cost of compliance & timing required for subsequent annual impairment test of goodwill

   From a financial statements preparer's perspective, it is time consuming to collate the assumptions and required inputs to develop a robust discounted cash flow ("DCF") model. A preparer lacking the necessary skills may also need to seek professional advice at their own cost to complete the annual impairment test. Because of the reasons discussed above we concur with the Board to expense the resulting goodwill arising from the acquisition of a non-cash-generating operation.

   We would like to suggest the Board include the definitions of "cash-generating" and "non-cash generating" operations and provides clear guidance to identify them in the Standard as the current Glossary of Defined Terms only contains definitions for cash-generating assets and cash-generating units.

   (g) Identifying an acquirer (para 44)

   We agree that it is helpful to the users to add guidance on identifying an acquirer in a reverse acquisition.

   (h) Transition (para 45 – 47)

   We agree with the transition provisions that are set out in paragraphs 134.1 – 134.3 of the proposed Standards.

   (i) Voluntary combination not under common control (para 48)

   We agree with the added guidance and illustrative example for such combination although this is not expected to have a significant impact on Auckland Council Group.

   (j) Selection of accounting policies by the resulting entity (para 49)

   We agree with the clarification of selection of accounting policies in AG54.1 – AG54.2.

   (k) Income taxes (para 50 – 51)

   We agree with NZASB's decision.

2. Do you agree with the changes (as listed in Table 2) made by NZASB in developing the proposed PBE IPSAS 40? If not, please explain why not and identify what you think would be more appropriate. (para 52 | Table 2)

   Yes, we agree with the changes made in Table 2.

3. Do you agree with retaining paragraphs 13(b) and AG36 in the proposed PBE IPSAS 40? If you disagree, please provide reasons (para 53)

   We agree with retaining paragraph 13(b) and AG36 in the proposed PBE IPSAS 40. Whilst it may be remote for a referendum to happen in the New Zealand context, the Council consults with the public and residents of Auckland may be part of the decision-making process.

4. Do you agree with the concessions and associated RDR paragraphs in the proposed PBE IPSAS 40? If you disagree, please provide reasons and indicate any additional concessions or RDR paragraphs that you consider would be appropriate. (para 54 – 56)

   We support the proposed RDR concessions although this is not expected to impact Auckland Council Group

5. Do you agree with the proposed effective date of 1 January 2021, with early adoption permitted? If you disagree, please provide reasons. (para 58 – 59)

   We agree with the proposed effective date of 1 January 2021 as this will allow time for PBEs to plan their combination activities prior to the effect date. Considering that the proposed standard deviates from IPSAS 40 in many areas, we suggest that NZASB to consider providing a list of difference between PBE IPSAS 40 and IPSAS 40 upon issuance.

6. Do you have any other comments on the Exposure Draft?

   We have no further comments.

AUDIT NEW ZEALAND
Mana Arotake Aotearoa

12 February 2019

Warren Allen
Chief Executive
External Reporting Board
PO Box 11250
Manners Street Central
Wellington 6142

Dear Warren

NZASB Exposure Draft 2018-4 – PBE Combinations (PBE IPSAS 40)

We appreciate the opportunity to provide comments to the New Zealand Accounting Standards Board on ED 2018-4 PBE Combinations.

In summary, we are very supportive of the NZASB issuing a Standard on PBE Combinations and we believe that the approach taken by the IPSAS Board in IPSAS 40 would result in sensible accounting in the public sector. We do however have some significant concerns about some of the extensive changes that the NZASB is proposing to make to the content of IPSAS 40 as issued by the IPSAS Board.

Note that our views are based on our knowledge and experience of public sector accounting and public sector combinations and we have focussed on the consequences for the public sector in forming our responses to the ED.

We set out our views in the attached document, which also provides our responses to the specific questions posed by the NZASB.

If you would like to discuss any of our comments, please phone me on 021 222 6107 or email me at robert.cox@auditnz.govt.nz.

Yours sincerely

Robert Cox
Director and Head of Accounting
Audit New Zealand

Our responses to the questions in the Invitation to Comment

1 **Do you agree with the changes (as listed below) made by the NZASB in developing the proposed PBE IPSAS 40? If not, please explain why not and identify what you think would be more appropriate.**

(a) Indicators relating to consideration

(b) Definitions of equity interests and owners

(c) Use of the term "new entity"

(d) Applying the modified pooling of interests method

(e) Presentation of financial statements and disclosures

(f) Acquiring a non-cash-generating operation

(g) Identifying an acquirer

(h) Transition

(i) Voluntary combination not under common control

(j) Selection of the accounting policies by the resulting entity

(k) Income taxes

Our comments in relation to each of the matters (a) to (k) of your question 1 set out in your question are below.

(a) Indicators relating to consideration

We disagree with all of the changes made in relation to the indicators relating to consideration (paragraphs 12 and AG26 to AG 31). We find the IPSAS 40 as issued by the IPSAS Board clear and workable for the public sector in this area. We are concerned that the NZASB's amendments have resulted in a change in the outcome for scenario 6 in the illustrative examples from an amalgamation to an acquisition. This suggests the changes could result in a substantive divergence from IPSAS.

The NZASB's rationale for changes to this indicator, as we understand them from the invitation to comment paper, seems in part to be based on a concern that a donated operation should be able to be accounted for as an acquisition. In our opinion, the unamended IPSAS 40 already dealt with this adequately by requiring the reasons for no consideration to be considered (paragraph AG30) and also by including a specific example that a bequest of an operation may be acquisition (paragraph AG29).

Rather than the extensive changes made in relation to this indicator, we suggest the concerns the NZASB may have could have been addressed by adding in another specific guidance example from a NFP context. Also illustrative example scenario 6 could be amended to include further assessment of the reasons for no consideration and possibly assessment of the "additional matters" in paragraph 14 before concluding. A conclusion that this scenario could be either an acquisition or an amalgamation depending on the specific circumstances could be appropriate.

(b) Definitions of equity interests and owners

We are comfortable with these changes.

(c) Use of the term "new entity"

We consider the revised requirements are clearer than the original IPSAS document in this aspect.

(d) Applying the modified pooling of interests method

We disagree with the changes to paragraph 21 and 23.

The guidance about restructuring costs following amalgamations in paragraph 23 is useful (and almost identical to the content in paragraph 65 for restructuring costs following acquisitions) and it is unclear why it has been deleted.

Paragraph 21 as originally drafted appears to limit the recognition of assets and liabilities to those previously recognised by the combining entities. This appears sensible. The NZASB's changes suggest that under PBE IPSAS 40 additional assets and liabilities can be recognised in an amalgamation, which cannot be recognised under IPSAS 40. If so, this change should be made clearer and the types of assets and liabilities that should/could be recognised discussed. If this change is driven by any concerns about entities that have previously used tier 3 or 4 standards, we suggest that this is dealt with in a different way.

We are generally comfortable with the proposed changes to paragraphs 20.1, AG50.1, AG50.2. We suggest that AG50.2(c) should be amended to refer to the accounting policies of the new reporting entity, as it is possible that the combining entities previously had inconsistent accounting policies. This change would also be consistent with the requirement of paragraph 27.

(e) Presentation of financial statements and disclosures

We agree with the NZASB's proposals in this regard (paragraphs 50 to 54 and AG64).

(f) Acquiring a non-cash-generating operation

We disagree with the NZASB's amendments to IPSAS 40 (and PBE IPSAS 26) in regard to acquisition of a non-cash generating operation that results in a reduction in net outflows of the acquirer. We consider that a better option than the IPSAS Board's approach (allocate to entire entity) or the NZASB's approach (expense) would be to allocate the goodwill to the cash-generating units that are expected to benefit from the combination (as per existing PBE IPSAS 26 paragraph 90.1).

(g) Identifying an acquirer

The inclusion of content from PBE IFRS 3 paragraph B15(c) and (d) has merit. However paragraph AG14 is not about identifying an acquirer; it is about identifying whether one entity has gained control over another. We suggest that the term "acquirer" is changed as it implies acquisition, whereas the guidance in AG14 can be relevant to combinations that may either amalgamations or acquisitions.

We disagree with the amendments made to paragraph AG17. We consider this paragraph as drafted by IPSAS Board was clear in meaning. The amendments make it less clear. We do not consider any amendment is required to AG17 to address B15(c) and (d) of PBE IFRS 3.

(h) Transition

We agree with the proposed transitional provisions.

(i) Voluntary combination not under common control

We are comfortable with new paragraph AG17.1 and new scenario 15.

(j) Selection of the accounting policies by the resulting entity

We agree with the NZASB's proposals in this regard (paragraphs AG54.1, AG54.2).

(k) Income taxes

We are comfortable with these changes. We note however that the heading above paragraph 78 is "Income taxes (where included in the terms of acquisition)". The new paragraphs 79.1 and 79.2 apply whether or not tax is covered in the terms of acquisition, so may need a separate heading.

2 **Do you agree with the changes (as listed in Table 2 above) made by the NZASB in developing the proposed PBE IPSAS 40? If not, please explain why not and identify what you think would be more appropriate.**

We disagree with many of these changes. Our detailed response is in appendix one.

3 **Do you agree with retaining paragraphs 13(b) and AG36 in the proposed PBE IPSAS 40? If you disagree, please provide reasons.**

Yes we strongly support retaining paragraphs 13(b) and AG36. We note that reorganisations of local authorities under Schedule 3 of the Local Government Act 2002 may involve a poll of electors in the affected area. Therefore this indicator is of direct relevance to New Zealand local government.

4 **Do you agree with the concessions and associated RDR paragraphs in the proposed PBE IPSAS 40? If you disagree, please provide reasons and indicate any additional concessions or RDR paragraphs that you consider would be appropriate.**

Yes, we agree with the concessions and associated RDR paragraphs.

5 **Do you agree with the proposed effective date of 1 January 2021, with early adoption permitted? If you disagree, please provide reasons.**

We agree with the NZASB's proposed approach.

6 **Do you have any other comments on the Exposure Draft?**

Our summary view is that we consider that the NZASB has made too many changes to the core IPSAS standard.

While some of the NZASB's changes have improved the understandability or consistency of the original IPSAS document, there are many changes that in our opinion do not significantly improve the standard and are not necessary for the standard to work effectively in the New Zealand environment.

We reviewed the XRB document "Policy Approach to Developing the Suite of PBE Standards" (updated December 2018), as we believe this is the document that should guide the NZASB in its consideration of standards issued by the IPSAS Board. In our view, some of the amendments being proposed do not meet the amendment circumstances described in paragraph 24 of this policy document.

(a) Amend a recently issued or newly amended IPSAS in the process of adoption in New Zealand. Examples of possible amendments include:

(i) improving the quality of the IPSAS in the New Zealand context by, for example, adding guidance or making changes to enhance the clarity and consistency of the requirements to enable public sector PBEs and NFP PBEs to apply the standard consistently;

(ii) adding guidance to assist NFP PBEs in applying the standard, given that the standard has been developed for application by public sector PBEs;

(iii) amending as necessary to maintain the coherence of the suite of PBE Standards;

(iv) excluding options that are not relevant in the New Zealand context; or

(v) amending the scope of an IPSAS if the IPSAS conflicts with a legislative requirement, or a legislative requirement addresses the same issue for public sector entities. However, in these circumstances, it may be appropriate to adopt the IPSAS for NFP PBEs.

Audit New Zealand is supportive of the NZASB making changes to the IPSAS standards where it is necessary for the standards to best meet the needs of the New Zealand public and not-for-profit sectors and we support the approach set out in the XRB policy document referred above.

We believe some of the substantive changes made by the NZASB are not necessary and we do not support extensive editorial changes to the IPSAS issued standards.

We are also concerned that too much amendment to the requirements of the IPSAS standards will make it difficult for the New Zealand public sector to explain the standards they are applying to international bodies. Currently the Financial Statements of the Government of New Zealand state:

These financial statements have been prepared in accordance with Public Sector PBE Accounting Standards (PBE Standards) – Tier 1. These standards are ***based on*** *International Public Sector Accounting Standards (IPSAS). [emphasis added].*

At some point in the future, we may be asked to explain what is meant by “based on” or to explain the differences between New Zealand’s PBE IPSAS and IPSAS as issued by the IPSAS Board. The more changes that are made, the harder it becomes to answer this question.

We consider that all new substantive differences to the original IPSAS need to be well justified and explained in each new Standard’s Basis for Conclusions and we are pleased that the NZASB has included a discussion of some of the more substantive changes in the Basis for Conclusions. However, the NZASB has proposed some other potentially substantive changes that are not discussed in the Basis for Conclusions.

We would also prefer that wherever possible substantive changes to the original IPSAS were presented within the Standard in a way that makes them clearly identifiable to the reader.

Appendix 1: Table of detailed responses to consultation question 2

Paragraph(s)	XRB Comments	Audit NZ comments
5	Aligned the definition of an operation with the definition of a business in PBE IFRS 3.	Agree.
16(c), 21, 26, 28, 30, 41, 42, AG54, IE166, IE173, IE174	Removed reference to "identifiable" assets in the guidance for amalgamations. This is a defined term that is specifically linked to the recognition of intangible assets. The use of the word identifiable is appropriate under acquisition accounting which requires the separation of identifiable intangible assets but does not seem necessary when discussing amalgamations.	Disagree. We do not support this change without a clear explanation in the basis for conclusions of the standard explaining why the change has been made and the consequences (if any) of it. We find it unclear from the ED what deleting the term "identifiable" for amalgamations and retaining it for acquisitions is intended to achieve. If the intention of the proposal is that PBE amalgamations can recognise some non-identifiable assets that cannot be directly recognised in an acquisition, then this should be made clearer. The one example we thought of might be the treatment of goodwill previously recognised by a combining entity in an amalgamation (although this is covered by AG60).
20	Deleted the example because the necessary information about determining the date control is obtained is in the other sentences in paragraph 20.	Disagree. The example is useful and is not elsewhere in paragraph 20.
21, 26	Clarified that the recognition and measurement principles of an amalgamation are subject to the exceptions in paragraph 31 of the proposed PBE IPSAS 40.	Disagree. Paragraph 21. Although the reference to the exceptions in paragraph 31 may be helpful, the remaining editorial changes are not necessary. It is unclear why the phrase "**that are recognized in the financial statements of the combining operations"** has been deleted. Does this mean under PBE IPSAS 40 additional assets and liabilities can be recognised in an amalgamation, which cannot be under IPSAS 40? If so, this change should be made clearer.
24	Changed the requirement to allow for situations where the resulting entity might be required to adopt a different classification or designation in order to comply with PBE Standards. IPSAS 40 does not allow for that possibility.	Agree.
37	Clarified that the net amount from the total of sub-paragraphs (a)–(c) is recognised in net assets/equity.	Editorial change. Not necessary, but does no harm other than diverging from "pure" IPSAS.

37(a)	Provided clarity as to which combining operations are being referred to.	Editorial change. Not necessary, but does no harm other than diverging from “pure” IPSAS.
39(b)	Clarified that the existing net assets/equity balances, such as reserves of the combining operations can be retained and shown separately by the resulting entity.	Disagree. The editorial change is less clear than the original text.
87	Clarified that the recognition of goodwill in an acquisition where no consideration is transferred is limited to situations where achieved through changes in voting rights, by contract alone or similar circumstances.	Disagree. It is not clear to us that the IPSAS Board intended this paragraph to be limited to the circumstances in paragraphs 101 and 102.
94	Removed the reference to paragraph 86 because that paragraph provides requirements on the recognition of goodwill. Paragraph 94 does not permit the recognition of goodwill.	Editorial change. Not necessary, but does no harm other than diverging from “pure” IPSAS. Note that the reference to paragraph 86 makes sense as the final sentence of paragraph 86 deals with recognition of the ‘excess’ in surplus or deficit.
106	Clarified that increases or decreases in goodwill are subject to the requirements for recognition of goodwill in paragraph 86.	Editorial change. Not necessary, but does no harm other than diverging from “pure” IPSAS.
AG4	Added examples of inputs and processes from PBE IFRS 3 paragraph B7. Aligned the description of an output with PBE IFRS 3 paragraph B7.	Agree.
AG23	Clarified that there might be circumstances in which there are controlling entity/controlled entity relationships after an amalgamation and added an example to illustrate this.	Agree. Useful additional guidance.
AG24	Removed the discussion of the types of benefits or service potential obtained because this does not affect the classification of the combination.	Agree. Meaning of original IPSAS text not clear to us.
AG25	Removed paragraph because it repeats matters already covered in paragraph AG21.	Disagree. AG25 is quite different to AG21.
AG43, AG44, table in AG45	Deleted the sentence about future cash flows associated with assets and liabilities as other considerations tend to be more important in the public sector and NFP sector context.	Disagree. The sentence in AG43, AG44 and AG45 about future cash flows is relevant and useful guidance in some public sector circumstances.
AG44, table in AG45	Added “where paid” because not all investments would have involved consideration.	Editorial change. Not necessary, but does no harm other than diverging from “pure” IPSAS.
AG53	Removed paragraph because it was not necessary and could create confusion.	Disagree. The paragraph is technically correct. Agree it is not that important but is that reason enough to delete it.
AG54	Deleted the last sentence because it does not seem to be consistent with paragraphs 26–27 and therefore could create confusion.	Disagree. AG54 continues the discussion from AG53 and is technically correct. We agree the wording could be improved.
AG65, AG113	Removed paragraphs because regulators always have the option to require additional information and these paragraphs are not establishing a requirement.	Disagree. These guidance paragraphs are technically correct and there is no need to make this change from IPSAS 40.

AG66	Replaced "public sector entity" with "unlisted entity" to allow for application by both NFPs and public sector entities.	Agree.
AG79	Added an example of the acquirer's trade name (under a network and partner agreement) to broadly align with PBE IFRS 3 paragraph B35.	Agree.
IE69, IE79, IE83, IE127, IE136	Replaced the word "seller" with references to either the owner of the acquired operation or the acquired operation because the combination does not involve the actual sale of the acquired operation.	Editorial change. Not necessary, but does no harm other than diverging from "pure" IPSAS. We consider the intent was to use the exact words from AG26 (which uses "seller") to demonstrate the application of that paragraph.
IE145, IE154	Removed reference to compensating the seller for giving up an entitlement to the net assets of an operation because both examples are bailouts where the seller receives no compensation and there is a transfer of net liabilities rather than net assets	Editorial change. Not necessary, but does no harm other than diverging from "pure" IPSAS. We consider the intent was to use the exact words from AG26 (which uses "seller") to demonstrate the application of that paragraph.
IE154	Removed the phrase "…analogous to paying consideration" because it was not clear how taking on net liabilities is analogous to paying consideration. Added the phrase "…no payment of consideration is necessary" because the acquirer is taking on net liabilities and there is no payment for the acquired operation.	Editorial change. Not necessary, but does no harm other than diverging from "pure" IPSAS.

NZ ACCOUNTING STANDARDS BOARD

Memorandum

Date:	8 March 2019
To:	NZASB Members
From:	Joanne Scott
Subject:	PBE Financial Instruments

Recommendations[1]

1. We recommend that the Board:

   (a) NOTES submissions received on NZASB ED 2018-5 PBE IPSAS 41 *Financial Instruments* and NZASB ED 2018-6 *Effective Date of PBE IFRS 9*;

   (b) AGREES, in response to an issue raised by a constituent, to include an additional transition provision in the proposed PBE IPSAS 41 (for financial guarantee contracts issued through a non-exchange transaction whose fair value could not previously be reliably measured at initial recognition);

   (c) APPROVES for issue PBE IPSAS 41 *Financial Instruments* (agenda item 6.3);

   (d) APPROVES for issue *Effective Date of PBE IFRS 9* (agenda item 6.4); and

   (e) APPROVES the signing memo.

Structure of this memo

2. This memo has the following sections:

   (a) Background;

   (b) Submissions received;

   (c) Transition issue raised;

   (d) Seeking approval to issue; and

   (e) Next steps.

Background

3. The objective of this project is to develop a PBE Standard based on IPSAS 41 *Financial Instruments*. This will align PBE Standards with IPSAS 41 and IFRS 9 *Financial Instruments*, which will update PBE Standards for the most recent international requirements for financial

[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® Standards, IFRIC® Interpretations and IASB® papers).

instruments. It will also address mixed group issues more comprehensively than PBE IFRS 9 *Financial Instruments*, which was issued as an interim standard in January 2017.

4. We issued an Invitation to Comment and two exposure drafts (EDs) in mid-November 2018. Comments were due by 28 February 2019. The following documents were available on the XRB's website.
   (a) Invitation to Comment;
   (b) ED 2018-5 PBE IPSAS 41 *Financial Instruments*;
   (c) ED 2018-6 *Effective Date of PBE IFRS 9*;
   (d) an In Summary document;
   (e) a marked-up copy of ED 2018-5 PBE IPSAS 41; and
   (f) a copy of IPSAS 41.

5. The ITC acknowledged that some entities would have already early adopted, or might be in the process of adopting, PBE IFRS 9. The ITC therefore had separate sections entitled:
   (a) Moving from PBE IPSAS 29 to PBE IPSAS 41; and
   (b) Moving from PBE IFRS 9 to PBE IPSAS 41.

6. The ITC explained the main differences between the proposed PBE IPSAS 41 and IPSAS 41. For example, the proposed PBE IPSAS 41 included a few paragraphs that were inadvertently omitted from IPSAS 41 and aligned the dividend and interest revenue requirements throughout PBE Standards. We expect the IPSASB to address these matters in due course. The ITC also summarised the key differences between PBE IPSAS 29 and PBE IPSAS 41.

7. Table 1 summarises the proposals in PBE IPSAS 41 and *Effective Date of PBE IFRS 9*.

Table 1: Summary of proposals

PBE IPSAS 41	<u>New PBE Standard</u> • New classification requirements • New recognition and measurement requirements • New hedging requirements Supersedes most of PBE IPSAS 29 *Financial Instruments: Recognition and Measurement* (apart from the hedging requirements which will still be available as an option) Supersedes PBE IFRS 9 *Financial Instruments* which was issued as interim measure to address mixed group issues and to give PBEs the option of adopting newer requirements Significant changes to PBE IPSAS 28 *Financial Instruments: Presentation* Significant changes to PBE IPSAS 30 *Financial Instruments: Disclosures* Includes transitional provisions for PBEs transitioning from PBE IPSAS 29, and for those transitioning from PBE IFRS 9 Includes more narrow scope amendments than PBE IFRS 9 (see Table 2)

Effective Date of PBE IFRS 9	<u>Amending PBE Standard</u> Defers the effective date of PBE IFRS 9 by a year (to prevent it becoming effective for all PBEs before PBE IPSAS 41 becomes effective). Limits the ability of entities to early adopt PBE IFRS 9 following the issue of PBE IPSAS 41. Entities must adopt PBE IFRS 9 before 1 January 2020.

Table 2: Additional narrow scope amendments and interpretations in PBE IPSAS 41

- *Classification of Rights Issues* (Amendment to IAS 32) (October 2009)
- IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments* (November 2009)
- *Improvements to IFRSs* (May 2010) – a few of these amendments were addressed in PBE IFRS 9 but more have been addressed in PBE IPSAS 41
- *Disclosures—Transfers of Financial Assets* (Amendments to IFRS 7) (October 2010)
- *Offsetting Financial Assets and Financial Liabilities* (Amendments to IAS 32) (December 2011)
- *Disclosures—Offsetting Financial Assets and Financial Liabilities* (Amendments to IFRS 7) (December 2011)
- *Annual Improvements to IFRSs 2012–2014 Cycle* (September 2014)
- *Prepayment Features with Negative Compensation* (Amendments to IFRS 9) (October 2017)
- *Long-term Interests in Associates and Joint Ventures* (Amendments to IAS 28) (October 2017)

8. Staff carried out the following awareness raising and outreach activities.

   (a) We highlighted the EDs at the Experienced Finance Professionals[2] (EFP) forum for the state sector and placed a notice on the EFP forum intranet.

   (b) We alerted Charities Services to the proposals in the EDs and placed a notice about the EDs on Charities Services' website.

   (c) We notified Audit New Zealand, the Reserve Bank of New Zealand, the New Zealand Society of Local Government Managers, Local Government New Zealand, and a number of the larger local authorities (16) about the proposals.

   (d) We recorded a webinar in December and mentioned the webinar in NZASB Updates.

9. At this stage it is two years since PBE IFRS 9 was issued. Table 3 identifies PBEs that have early adopted PBE IFRS 9.

Table 3: Which reporting entities have early adopted PBE IFRS 9?

Government of New Zealand	Yes – applying PBE IFRS 9 from 1 July 2018 The Government reporting entity as specified in Part III of the Public Finance Act 1989 comprises: • Ministers of the Crown • Government departments • Crown entities (excluding tertiary education institutions) • Air New Zealand Limited • Offices of Parliament • New Zealand Superannuation Fund • the Reserve Bank of New Zealand • State-owned Enterprises (SOEs)

2 This is a forum organised by Treasury for finance professionals in the state sector to share knowledge of relevant topics

	• Organisations listed in Schedule 4 and 4A of the Public Finance Act 1989 • Organisations listed in Schedule 5 of the Public Finance Act 1989 • Legal entities listed in Schedule 6 of the Public Finance Act 1989 • Other Government entities specified by legislation
Local authorities	Auckland City Council has early adopted PBE IFRS 9. We checked a selection of local authority financial statements (26) and have not identified any other local authorities that have early adopted PBE IFRS 9. One noted it was contemplating doing so.
Other public sector PBEs	We do not have information on other public sector PBEs.
NFP PBEs	We do not have information on NFP PBEs but we think it is unlikely that many have early adopted PBE IFRS 9. Mixed groups issues are not expected to be as prevalent for these entities and many have relatively few types of financial instruments.

Submissions received

10. We received three submissions, all of which were broadly supportive.

    R1 PwC

    R2 Auckland City Council

    R3 Audit New Zealand

11. Table 4 lists the ITC questions and indicates the response to those questions. There is one matter that needs to be considered by the Board – R3's response to Question 6 is discussed in the next section of the memo.

Table 4: ITC questions

	ED 2018-5 PBE IPSAS 41 *Financial Instruments*
Q1	Do you agree that the proposed requirements in ED 2018-5 are appropriate for a new PBE Standard? If you disagree, please explain why not and outline any alternative proposals. R1 Agree R2 Agree R3 Agree
Q2	Do you agree with the proposal to locate dividend and interest revenue requirements in PBE IPSAS 41 rather than PBE IPSAS 9? If not, please explain why not. R1 Agree R2 Agree R3 Agree
Q3	Do you agree with the proposed RDR concessions? If you disagree, please provide reasons and indicate what concessions you consider would be appropriate. R1 Agree R2 Agree R3 Agree

Q4 For entities moving from PBE IFRS 9, do you agree with the proposed transition provisions? If not, please explain why not and identify what you think would be more appropriate.
R1 Agree
R2 Agree
R3 Agree

Q5 Do you agree with the proposed effective date for PBE IPSAS 41 (being 1 January 2022)? If not, please explain why not and identify what you think would be more appropriate.
R1 Agree
R2 Agree
R3 Agree

Q6 Do you have any other comments on ED 2018-5?
R1 No
R2 No
R3 Requested additional transition relief in PBE IPSAS 41.

ED 2018-6 *Effective Date of PBE IFRS 9*

Q7 Do you agree with the proposal to defer the effective date of PBE IFRS 9 to 1 January 2022 (so that PBE IFRS 9 does not become mandatorily effective before PBE IPSAS 41)?
R1 Agree
R2 Agree
R3 Agree

Q8 Do you agree with the proposal to limit the ability of entities to early adopt PBE IFRS 9 once PBE IPSAS 41 has been issued (a six-month period is proposed)?
R1 Agree
R2 Agree
R3 Agree

Q9 Do you have any other comments on ED 2018-6?
R1 No
R2 No
R3 No

Transition issue raised

12. R3 recommended that the Board add a transition relief provision to PBE IPSAS 41 in relation to the measurement of financial guarantee contracts issued in a non-exchange transaction whose fair value could not previously be reliably measured at fair value. We support R3's request and have drafted an additional relief provision for consideration by the Board. We have outlined the background to this issue.

Background to the issue

13. PBEs sometimes issue financial guarantee contracts for no or nominal consideration or at less than fair value. The purposes include supporting infrastructure projects, supporting corporate entities at times of economic distress and guaranteeing the bond issues of other entities.

14. When the IPSASB first issued IPSAS 29 *Financial Instruments: Recognition and Measurement* it acknowledged that this issue is not public sector specific, but it argued that there were public sector specific reasons for modifying the initial measurement requirements in IFRS. The reasons included prevalence of such transactions, differing motivations for making such guarantees compared to the private sector, the frequent absence of active markets and the costs of applying valuation techniques.

15. The IPSASB did not give a blanket exemption from the fair value initial measurement requirement in IFRS. Rather, an entity had to first check whether a reliable measure of fair value could be determined by direct observation of a direct market or through another valuation technique. Only then could it apply the use the public sector modification – which was to apply the principles of IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* in determining the initial value of the financial guarantee contract.

<u>IPSAS 41/ PBE IFRS 9/ ED of PBE IPSAS 41 requirements</u>

16. The IPSASB also made a public sector modification in IPSAS 41 to deal with initial measurement of such financial guarantee contracts, but it updated the initial measurement requirements as shown below.

Extract from IPSAS 41

AG136 If no reliable measure of fair value can be determined … … an entity is required to measure the financial guarantee contract at the amount of the loss allowance determined in accordance with paragraphs 73 to 93.

17. The IPSASB did not give any additional transition relief for entities that had previously used the IPSAS 29 modification for financial guarantee contracts and then applied IPSAS 41.

18. PBE IFRS 9 and the ED of PBE IPSAS 41 have equivalent requirements to IPSAS 41.

<u>The issue to be addressed</u>

19. The problem identified by R3 relates to paragraph 45(c)(ii) (shown below). In the absence of a transition provision, an entity would have to retrospectively apply the initial measurement requirements in paragraph AG136 and determine the loss allowance (in accordance with paragraphs 73 to 93) for the financial guarantee contract *when it was first issued*. We agree with R3's concerns that this could involve undue cost and effort and propose to include an additional transition provision in PBE IPSAS 41.

20. If this were a major issue we might have recommended that we wait for the IPSASB to consider it. We consider that this is a relatively minor amendment and that it would be in the interests of New Zealand PBEs to finalise the standard promptly. We will let the IPSASB staff know what the Board decides and would expect the IPSASB to consider this matter at some stage, but not necessarily immediately.

21. We do not propose to change PBE IFRS 9 in respect of this issue. Entities that have early adopted PBE IFRS 9 have not identified the need for any additional transition relief and for those entities, there is now no advantage in providing further relief as they will have already retrospectively applied the subsequent measurement requirements in PBE IFRS 9. Possibly the amounts involved have not been material.

<u>Proposed additional transition provision (and related changes)</u>

22. The proposed additional transition provision is set out in paragraph 169.1 (shown below). Paragraph 45 is shown for context.

Classification of Financial Liabilities

45. **An entity shall classify all financial liabilities as subsequently measured at amortised cost, except for:**

    (a) **Financial liabilities at fair value through surplus or deficit. Such liabilities, including derivatives that are liabilities, shall be subsequently measured at fair value.**

    (b) **Financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies. Paragraphs 26 and 28 apply to the measurement of such financial liabilities.**

    (c) **Financial guarantee contracts. After initial recognition, an issuer of such a contract shall (unless paragraph 45(a) or (b) applies) subsequently measure it at the higher of:**

        (i) **The amount of the loss allowance determined in accordance with paragraphs 73–93; and**

        (ii) **The amount initially recognised (see paragraph 57) less, when appropriate, the cumulative amount of amortisation recognised in accordance with the principles of PBE IPSAS 9.**

    (d) **Commitments to provide a loan at a below-market interest rate. An issuer of such a commitment shall (unless paragraph 45(a) applies) subsequently measure it at the higher of:**

        (i) **The amount of the loss allowance determined in accordance with paragraphs 73–93; and**

        (ii) **The amount initially recognised (see paragraph 57) less, when appropriate, the cumulative amount of amortisation recognised in accordance with the principles of PBE IPSAS 9.**

    (e) **Contingent consideration recognised by an acquirer in a business combination to which PBE IFRS 3 applies. Such contingent consideration shall subsequently be measured at fair value with changes recognised in surplus or deficit.**

…

<u>169.1 Despite the requirements in paragraphs 45(c)(ii) and AG136, an entity that was previously unable to determine a reliable measure of the fair value of a financial guarantee contract issued through a non-exchange transaction shall, at the date of initial application, measure the contract at the higher of:</u>

<u>(a) the loss allowance determined in accordance with paragraphs 73–93; and</u>

<u>(b) the previous carrying amount determined in accordance with PBE IPSAS 29.</u>

<u>Any difference between the amount determined at the date of initial application and the previous carrying amount shall be recognised in the opening accumulated comprehensive revenue and expense of the reporting period that includes the date of initial application. The amount recognised at the date of initial application becomes the amount initially recognised in accordance with this Standard.</u>

23. We are also seeking feedback on what to do about PBE IPSAS 30 *Financial Instruments: Disclosures* paragraph AG5(h). This paragraph requires the disclosure of the circumstances associated with no determinable fair value on initial measurement of a financial guarantee contract. This paragraph refers to the recognition of a provision in accordance with PBE IPSAS 19 (which is no longer applicable to financial guarantees under PBE IPSAS 41). We note:

    (a) PBE IFRS 9 deleted this requirement from PBE IPSAS 30.

    (b) The IPSASB retained this requirement in IPSAS 30, including the reference to IPSAS 19.

(c) The ED of PBE IPSAS 41 was aligned with IPSAS 41 and proposed to retain the requirement.

(d) If we keep this disclosure requirement, it needs to be reworded to reflect the newer requirements in PBE IPSAS 41 paragraph AG136.

(e) We will inform IPSASB staff of this issue and the Board's views.

24. We are not sure how useful this disclosure is. We initially deleted it when we issued PBE IFRS 9 because of the outdated reference to recognising a provision in accordance with PBE IPSAS 19. Given that the IPSASB has decided to keep this disclosure, we propose to keep it, suitably reworded. Our suggested rewording is shown below.

Extract from PBE IPSAS 30 *Financial Instruments: Disclosures*

Other Disclosure—Accounting Policies (paragraph 25)

AG5. Paragraph 25 requires disclosure of the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements. For financial instruments, such disclosure may include:

…

(h) For financial guarantee contracts issued through a non-exchange transaction, where no fair value can be determined ~~and a provision is recognised in accordance with PBE IPSAS 19~~ ~~*Provisions, Contingent Liabilities and Contingent Assets*~~, disclosure of the ~~circumstances that result in a provision being recognised~~ <u>reasons why fair value was not determinable</u>.

25. We propose adding a new BC paragraph to acknowledge the issue identified by R3 and the Board's response.

<u>Transition from PBE IPSAS 29</u>

<u>BC13. With respect to entities transitioning from PBE IPSAS 29 the proposed transitional provisions in ED 2018-5 were based on the provisions in IFRS 9, PBE IFRS 9 and IPSAS 41. Respondents were generally in support of the proposals, although a respondent requested that the NZASB add a specific transition provision in relation to the measurement of financial guarantee contracts issued through a non-exchange transaction whose fair value could not previously be reliably measured at initial recognition. The NZASB added a specific transition provision (paragraph 169.1) in response to this request.</u>

26. We will advise respondents that the Board is considering comments on the EDs at this meeting and will give the Board a verbal update on any comments received on the proposals in this memo.

Questions for the Board

Q1 Does the Board agree to add paragraph 169.1?

Q2 Does the Board agree with the proposed change to PBE IPSAS 30 paragraph AG5(h)? Alternatively, would the Board prefer to delete PBE IPSAS 30 paragraph AG5(h)?

Q3 Does the Board agree with the proposed paragraph BC13?

Seeking approval to issue

27. We are seeking approval to issue:

    (a) PBE IPSAS 41 *Financial Instruments;* and

    (b) *Effective Date of PBE IFRS 9.*

28. In addition to the issues discussed in this memo, a few editorial changes are marked up in the proposed standard and amending standard.

Questions for the Board

Q4 Does the Board agree to issue PBE IPSAS 41 and *Effective Date of PBE IFRS 9*?

Q5 Does the Board approve the draft signing memo (at agenda item 6.5)?

Next steps

29. We will make any changes requested by the Board, follow the process agreed by the Board for finalising the documents, and issue the proposed standard and amending standard.

Attachments

Agenda item 6.2:	Submissions
Agenda item 6.3	Draft PBE IPSAS 41
Agenda item 6.4:	Draft *Effective Date of PBE IFRS 9*
Agenda item 6.5:	Draft signing memo

Warren Allen
Chief Executive Officer
External Reporting Board
PO Box 11250
Manners St Central
Wellington 6142

18 February 2019

NZASB Exposure Draft 2018-5 PBE IPSAS 41 Financial Instruments and NZASB Exposure Draft 2018-6 Effective Date of PBE IFRS 9

Dear Warren

The New Zealand Accounting Standards Board (NZASB) has sought comments on Exposure Draft *NZASB 2018-5: PBE IPSAS 41 Financial instruments* (ED 2018-5) and *NZASB Exposure Draft 2018-6: Effective date of PBE IFRS 9* (ED 2018-6). PwC New Zealand is pleased to present its comment letter.

We agree with the proposals in ED 2018-5 and the changes made by the NZASB in developing the proposed standard (for the reasons provided in the Invitation to Comment and the Basis for Conclusions supporting ED 2018-5).

We also agree with the proposal in ED 2018-6 to defer the effective date of PBE IFRS 9 to 1 January 2022 to prevent it becoming mandatorily effective before the effective date of PBE IPSAS 41.

Therefore we have no further comment to make in relation to questions 1 to 9 listed in the Invitation to Comment related to ED 2018-5 and ED 2018-6.

Should you wish to discuss the above, please do not hesitate to contact Richard Day on (09) 355 8824.

Yours sincerely

Jonathan Freeman
Partner
Assurance Leader

Auckland Council
Te Kaunihera o Tāmaki Makaurau

26 February 2019

Mr Warren Allen
Chief Executive
External Reporting Board
PO Box 11250
Manners St Central
Wellington 6142

Dear Warren

Auckland Council submission to NZASB ED 2018-5 PBE IPSAS 41 *Financial Instruments* and NZASB ED 2018-6 Effective Date of PBE IFRS 9

Thank you for the opportunity to comment on the exposure draft PBE IPSAS 41 *Financial Instruments* and NZASB ED 2018-6 *Effective Date of PBE IFRS 9.*

Auckland Council is Australasia's largest local government entity and is made up of the Council and six substantive council controlled organisations. We invest heavily in infrastructure and many of our decisions will have a fiscal impact on Auckland's future generations.

We have given our responses to the specific questions for the respondents as in Appendix 1 to this letter along with our additional comments for the XRB's consideration. In summary we are supportive of the changes made in developing the proposed PBE IPSAS 41.

We hope our responses and comments are helpful in aiding your decision-making process. Should you have any queries relating to the responses, please do not hesitate to contact Alvin Ang at the details provided below.

Yours sincerely

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Appendix 1 – Response to questions

We are generally supportive of the proposed requirements and changes made in the exposure draft.

ED 2018-5 PBE IPSAS 41 *Financial Instruments*

1. Do you agree that the proposed requirements in ED 2018-5 are appropriate for a new PBE Standard? If you disagree, please explain why not and outline any alternative proposals.

   We agree with the proposed requirements in ED 2018-5 as they are better aligned to PBE IFRS 9 which we have early adopted for the financial year ending 30 June 2019.

2. Do you agree with the proposal to locate dividend and interest revenue requirements in PBE IPSAS 41 rather than PBE IPSAS 9? If not, please explain why not.

   Yes. We agree with the proposal to locate dividend and interest revenue requirements in PBE IPSAS 41 to better align PBE Standards with NZ IFRS.

   We suggest removing the requirements for dividend and interest revenue in PBE IPSAS 9 to ensure consistency of requirements.

3. Do you agree with the proposed RDR concessions? If you disagree, please provide reasons and indicate what concessions you consider would be appropriate.

   We agree with the proposed RDR concessions although we do not expect this to have an impact on Auckland Council Group.

4. For entities moving from PBE IFRS 9, do you agree with the proposed transition provisions? If not, please explain why not and identify what you think would be more appropriate.

   Yes. We agree with the proposed transition provisions. Auckland Council group is an early adopter of PBE IFRS 9 in the same year as our for-profit subsidiaries and associates adopt NZ IFRS 9. We welcome the inclusion of additional narrow scope amendments and illustrative examples to refine the Standard. We do not expect to have material impacts from transitioning to PBE IPSAS 41.

5. Do you agree with the proposed effective date for PBE IPSAS 41 (being 1 January 2022)? If not, please explain why not and identify what you think would be more appropriate.

   Yes. We agree with the proposed effective date to be 1 January 2022 as this will allow most PBEs with sufficient time to transition themselves.

6. Do you have any other comments on ED 2018-5?

   We do not have any further comments.

ED 2018-6 *Effective Date of PBE IFRS 9*

7. Do you agree with the proposal to defer the effective date of PBE IFRS 9 to 1 January 2022 (so that PBE IFRS 9 does not become mandatorily effective before PBE IPSAS 41)?

   Yes. We agree with the proposal to defer the effective date of PBE IFRS 9 to 1 January 2022. This would allow most non-mixed groups ample time to transition themselves directly to PBE IPSAS 41 and save them from the inconvenience of transitioning to PBE IFRS 9 before PBE IPSAS 41.

8. Do you agree with the proposal to limit the ability of entities to early adopt PBE IFRS 9 once PBE IPSAS 41 has been issued (a six-month period is proposed)?

   Yes. We agree with the proposal to limit the ability of entities to early adopt PBE IFRS 9 once PBE IPSAS 41 has been issued.

9. Do you have any other comments on ED 2018-6?

   We do not have any further comments.

AUDIT NEW ZEALAND
Mana Arotake Aotearoa

28 February 2019

Warren Allen
Chief Executive
External Reporting Board
PO Box 11250
Manners Street Central
Wellington 6142

Dear Warren

NZASB Exposure Draft 2018-5 – PBE IPSAS 41 Financial Instruments and NZASB Exposure Draft 2018-6

We appreciate the opportunity to provide comments to the New Zealand Accounting Standards Board on ED 2018-5 and ED 2018-6.

We set out our views in the attached document, which also provides our responses to the specific questions posed by the NZASB.

If you would like to discuss any of our comments, please phone me on 021 222 6247 or email me at brett.story@auditnz.govt.nz.

Yours sincerely

B. Story

Brett Story
Associate Director, Technical
Audit New Zealand

Our responses to the questions in the Invitation to Comment

ED 2018-5 PBE IPSAS 41 *Financial Instruments*

1. **Do you agree that the proposed requirements in ED 2018-5 are appropriate for a new PBE Standard? If you disagree, please explain why not and outline any alternative proposals.**

   We agree.

2. **Do you agree with the proposal to locate dividend and interest revenue requirements in PBE IPSAS 41 rather than PBE IPSAS 9? If not, please explain why not.**

   We agree that these requirements should only be located within PBE IPSAS 41. This will also avoid possible different interpretations arising between the previous requirements in PBE IPSAS 9 and the requirements in PBE IPSAS 41.

   We encourage the NZASB to bring to the IPSASB's attention the duplicate dividend and interest revenue requirements in IPSAS 9 and IPSAS 41 with a view to amending IPSAS 9.

3. **Do you agree with the proposed RDR concessions? If you disagree, please provide reasons and indicate what concessions you consider would be appropriate.**

   We agree.

4. **For entities moving from PBE IFRS 9, do you agree with the proposed transition provisions? If not, please explain why not and identify what you think would be more appropriate.**

   We agree.

5. **Do you agree with the proposed effective date for PBE IPSAS 41 (being 1 January 2022)? If not, please explain why not and identify what you think would be more appropriate.**

   We agree. This provides entities that choose not to early adopt sufficient time to prepare and implement the new standard.

6. **Do you have any other comments on ED 2018-5?**

   We recommend that a transition relief provision be added to PBE IPSAS 41 in relation to the measurement of financial guarantee contracts issued in a non-exchange transaction whose fair value could not previously be reliably measured at initial recognition.

   Under PBE IPSAS 29 paragraph AG97, an entity would apply PBE IPSAS 19 at initial recognition when the fair value of a financial guarantee issued in a non-exchange transaction could not be reliably measured.

   > *AG97. **If no reliable measure of fair value can be determined, either by direct observation of an active market or through another valuation technique, an entity is required to apply the principles of PBE IPSAS 19 to the financial guarantee contract at initial recognition**. The entity assesses whether a present obligation has arisen as a result of a past event related to a financial guarantee contract whether it is probable that such a present obligation will result in a cash outflow in accordance with the terms of the contract and whether a reliable estimate can be made of the outflow. It is possible that a present obligation related to a financial guarantee contract will arise at initial recognition where, for example, an entity enters into a*

financial guarantee contact to guarantee loans to a large number of small enterprises and, based on past experience, is aware that a proportion of these enterprises will default.

If at initial recognition it was not probable a loss under the contract would occur, this would result in the financial guarantee contract being initially recognised at nil. Under the subsequent measurement requirements of PBE IPSAS 29, the entity would continue to measure the financial guarantee by reference to PBE IPSAS 19.

Under PBE IPSAS 41 paragraph AG136, if the fair value of a financial guarantee contract issued in a non-exchange transaction cannot be reliably determined at initial recognition it is measured based on application of the expected credit loss model.

AG136. If no reliable measure of fair value can be determined, either by direct observation of an active market or through another valuation technique, an entity is required to measure the financial guarantee contract at the amount of the loss allowance determined in accordance with paragraphs 73 to 93.

The different measurement requirements between PBE IPSAS 29 and PBE IPSAS 41 for financial guarantee contracts are shown below:

PBE IPSAS 29	**PBE IPSAS 41**
Initial measurement	
Fair value *(*Measure in accordance with PBE IPSAS 19 if fair value cannot be reliably measured)	Fair value *(*Measure in accordance with expected credit loss model if fair value cannot be reliably measured)
Subsequent measurement	
Measure it at the higher of: (i) The amount determined in accordance with PBE IPSAS 19; and (ii) The amount initially recognised (see paragraph 45) less, when appropriate, cumulative amortisation recognised in accordance with PBE IPSAS 9.	Measure it at the higher of: (i) The amount of the loss allowance determined in accordance with paragraphs 73–93; and (ii) The amount initially recognised (see paragraph 57) less, when appropriate, the cumulative amount of amortisation income recognised in accordance with the principles of PBE IPSAS 9.

There is no transition relief in PBE IPSAS 41 for an entity that previously applied paragraph AG97 of PBE IPSAS 29. This means on transition to PBE IPSAS 41, an entity would need to retrospectively apply para AG136 of PBE IPSAS 41 and determine the expected credit losses for the financial guarantee contract when it was first issued. The entity would then need to determine the expected credit losses of the contract at the date of transition to determine the amount of the liability on transition to PBE IPSAS 41 (the highest amount would be recognised).

There could be undue cost or effort in applying the expected credit loss model retrospectively for non-exchange financial guarantee contracts to determine what the initial amount of the liability was if the entity had applied PBE IPSAS 41 paragraph AG136.

We consider a transition concession should be provided so entities do not need to calculate the expected credit loss for a financial guarantee at initial recognition for non-exchange financial guarantee contracts whose fair value could not be reliably measured under PBE IPSAS 29. A possible concession would be for an entity to measure the financial guarantee at the higher of the amount previously recognised under PBE IPSAS 29 and the amount calculated by applying the expected credit loss model at the date of transition to the standard (either the start of the comparative year or start of the current year, depending on whether the entity has elected to restate comparatives on transition to PBE IPSAS 41).

ED 2018-6 *Effective Date of PBE IFRS 9*

7. **Do you agree with the proposal to defer the effective date of PBE IFRS 9 to 1 January 2022 (so that PBE IFRS 9 does not become mandatorily effective before PBE IPSAS 41)?**

   We agree.

8. **Do you agree with the proposal to limit the ability of entities to early adopt PBE IFRS 9 once PBE IPSAS 41 has been issued (a six-month period is proposed)?**

   We agree.

9. **Do you have any other comments on ED 2018-6?**

   No.

PUBLIC BENEFIT ENTITY INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD 41 FINANCIAL INSTRUMENTS (PBE IPSAS 41)

Issued March 2019

This Standard was issued on 28 March 2019 by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 12(a) of the Financial Reporting Act 2013.

This Standard is a disallowable instrument for the purposes of the Legislation Act 2012, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on 25 April 2019.

Reporting entities that are subject to this Standard are required to apply it in accordance with the effective date, which is set out in paragraph 156.

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.

This New Zealand Tier 1 and Tier 2 Public Benefit Entity Accounting Standard has been issued as a result of a new International Public Sector Accounting Standard – IPSAS 41 *Financial Instruments*.

This Standard, when applied, supersedes parts of PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*. These parts are identified in Appendix D of the Standard.

This Standard, when applied, supersedes PBE IFRS 9 *Financial Instruments*.

PBE IPSAS 41 FINANCIAL INSTRUMENTS

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PBE IPSAS 41 FINANCIAL INSTRUMENTS

CONTENTS

Public Benefit Entity International Public Sector Accounting Standard 41 *Financial Instruments* is set out in paragraphs 1–184.3 and Appendices A to D. All the paragraphs have equal authority. PBE IPSAS 41 should be read in the context of its objective, the NZASB's Basis for Conclusions on PBE IPSAS 41, the IPSASB's Basis for Conclusions on IPSAS 41, the *Public Benefit Entities' Conceptual Framework* and Standard XRB A1 *Application of the Accounting Standards Framework*. PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to establish principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows.

Scope

1.1 **This Standard applies to Tier 1 and Tier 2 public benefit entities.**

2. **This Standard shall be applied by all entities to all types of financial instruments except:**

   (a) **Those interests in controlled entities, associates and joint ventures that are accounted for in accordance with PBE IPSAS 34 *Separate Financial Statements*, PBE IPSAS 35 *Consolidated Financial Statements* or PBE IPSAS 36 *Investments in Associates and Joint Ventures*. However, in some cases, PBE IPSAS 34, PBE IPSAS 35 or PBE IPSAS 36 require or permit an entity to account for an interest in a controlled entity, associate or joint venture in accordance with some or all of the requirements of this Standard. Entities shall also apply this Standard to derivatives on an interest in a controlled entity, associate or joint venture unless the derivative meets the definition of an equity instrument of the entity in PBE IPSAS 28 *Financial Instruments: Presentation*.**

   (b) **Rights and obligations under leases to which PBE IPSAS 13 *Leases* applies. However:**

      (i) **Finance lease receivables (i.e., net investments in finance leases) and operating lease receivables recognised by a lessor are subject to the derecognition and impairment requirements of this Standard;**

      (ii) **Lease liabilities recognised by a lessee are subject to the derecognition requirements in paragraph 35 of this Standard; and**

      (iii) **Derivatives that are embedded in leases are subject to the embedded derivatives requirements of this Standard.**

   (c) **Employers' rights and obligations under employee benefit plans, to which PBE IPSAS 39 *Employee Benefits* applies.**

   (d) **Financial instruments issued by the entity that meet the definition of an equity instrument in PBE IPSAS 28 (including options and warrants) or that are required to be classified as an equity instrument in accordance with paragraphs 15 and 16 or paragraphs 17 and 18 of PBE IPSAS 28. However, the holder of such equity instruments shall apply this Standard to those instruments, unless they meet the exception in (a).**

   (e) **Rights and obligations arising under:**

      (i) **An insurance contract, other than an issuer's rights and obligations arising under an insurance contract that meets the definition of a financial guarantee contract in paragraph 9; or**

      (ii) **A contract that is within the scope of PBE IFRS 4 *Insurance Contracts* because it contains a discretionary participation feature.**

      This Standard applies to a derivative that is embedded in an insurance contract if the derivative is not itself an insurance contract (see paragraphs 47–53 and paragraphs AG99–AG106 of this Standard). An entity applies this Standard to financial guarantee contracts, but shall apply PBE IFRS 4 if the issuer elects to apply that standard in recognising and measuring them. Notwithstanding (i) above, an entity may apply this Standard to other insurance contracts which involve the transfer of financial risk.

   (f) **Any forward contract between an acquirer and a selling shareholder to buy or sell an acquiree that will result in an entity combination within the scope of PBE IFRS 3 *Business Combinations* at a future acquisition date. The term of the forward contract should not exceed a reasonable period normally necessary to obtain any required approvals and to complete the transaction.**

(g) **Loan commitments other than those loan commitments described in paragraph 4. However, an issuer of loan commitments shall apply the impairment requirements of this Standard to loan commitments that are not otherwise within the scope of this Standard. Also, all loan commitments are subject to the derecognition requirements of this Standard.**

(h) **Financial instruments, contracts and obligations under share-based payment transactions to which the relevant international or national accounting standard dealing with share-based payment applies, except for contracts within the scope of paragraphs 5–8 of this Standard to which this Standard applies.**

(i) **Rights to payments to reimburse the entity for expenditure that it is required to make to settle a liability that it recognises as a provision in accordance with PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*, or for which, in an earlier period, it recognised a provision in accordance with PBE IPSAS 19.**

(j) **The initial recognition and initial measurement of rights and obligations arising from non-exchange revenue transactions, to which PBE IPSAS 23 *Revenue from Non-Exchange Transactions* applies, except as described in paragraph AG6.**

(k) **Rights and obligations under service concession arrangements to which PBE IPSAS 32 *Service Concession Arrangements: Grantor* applies. However, financial liabilities recognised by a grantor under the financial liability model are subject to the derecognition provisions of this Standard (see paragraphs 35–38 and Appendix A paragraphs AG39–AG47).**

3. **The impairment requirements of this Standard shall be applied to those rights arising from PBE IPSAS 9 *Revenue from Exchange Transactions* and PBE IPSAS 23 transactions which give rise to financial instruments for the purposes of recognising impairment gains or losses.**

4. **The following loan commitments are within the scope of this Standard:**

(a) **Loan commitments that the entity designates as financial liabilities at fair value through surplus or deficit (see paragraph 46). An entity that has a past practice of selling the assets resulting from its loan commitments shortly after origination shall apply this Standard to all its loan commitments in the same class.**

(b) **Loan commitments that can be settled net in cash or by delivering or issuing another financial instrument. These loan commitments are derivatives. A loan commitment is not regarded as settled net merely because the loan is paid out in instalments (for example, a mortgage construction loan that is paid out in instalments in line with the progress of construction).**

(c) **Commitments to provide a loan at a below-market interest rate (see paragraph 45(d)).**

5. **This Standard shall be applied to those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements. However, this Standard shall be applied to those contracts that an entity designates as measured at fair value through surplus or deficit in accordance with paragraph 6.**

6. **A contract to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contract was a financial instrument, may be irrevocably designated as measured at fair value through surplus or deficit even if it was entered into for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements. This designation is available only at inception of the contract and only if it eliminates or significantly reduces a recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise from not recognising that contract because it is excluded from the scope of this Standard (see paragraph 5).**

7. There are various ways in which a contract to buy or sell a non-financial item can be settled net in cash or another financial instrument or by exchanging financial instruments. These include:

(a) When the terms of the contract permit either party to settle it net in cash or another financial instrument or by exchanging financial instruments;

(b) When the ability to settle net in cash or another financial instrument, or by exchanging financial instruments, is not explicit in the terms of the contract, but the entity has a practice of settling similar contracts net in cash or another financial instrument or by exchanging financial instruments (whether with the counterparty, by entering into offsetting contracts or by selling the contract before its exercise or lapse);

(c) When, for similar contracts, the entity has a practice of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin; and

(d) When the non-financial item that is the subject of the contract is readily convertible to cash.

A contract to which (b) or (c) applies is not entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements and, accordingly, is within the scope of this Standard. Other contracts to which paragraph 5 applies are evaluated to determine whether they were entered into and continue to be held for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements and, accordingly, whether they are within the scope of this Standard.

8. A written option to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, in accordance with paragraph 7(a) or 7(d) is within the scope of this Standard. Such a contract cannot be entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements.

Definitions

9. **The following terms are used in this Standard with the meanings specified:**

<u>12-month expected credit losses</u> are the portion of lifetime expected credit losses that represent the expected credit losses that result from default events on a financial instrument that are possible within the 12 months after the reporting date.

The <u>amortised cost of a financial asset or financial liability</u> is the amount at which the financial asset or financial liability is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any loss allowance.

A <u>credit-impaired financial asset</u> is a financial asset that is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred. Evidence that a financial asset is credit-impaired include observable data about the following events:

(a) **Significant financial difficulty of the issuer or the borrower;**

(b) **A breach of contract, such as a default or past due event;**

(c) **The lender(s) of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession(s) that the lender(s) would not otherwise consider;**

(d) **It is becoming probable that the borrower will enter bankruptcy or other financial reorganisation;**

(e) **The disappearance of an active market for that financial asset because of financial difficulties; or**

(f) **The purchase or origination of a financial asset at a deep discount that reflects the incurred credit losses.**

It may not be possible to identify a single discrete event—instead, the combined effect of several events may have caused financial assets to become credit-impaired.

<u>Credit loss</u> is the difference between all contractual cash flows that are due to an entity in accordance with the contract and all the cash flows that the entity expects to receive (i.e., all cash shortfalls), discounted at the original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets). An entity shall estimate cash flows by

considering all contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) through the expected life of that financial instrument. The cash flows that are considered shall include cash flows from the sale of collateral held or other credit enhancements that are integral to the contractual terms. There is a presumption that the expected life of a financial instrument can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the expected life of a financial instrument, the entity shall use the remaining contractual term of the financial instrument.

Credit-adjusted effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts through the expected life of the financial asset to the amortised cost of a financial asset that is a purchased or originated credit-impaired financial asset. When calculating the credit-adjusted effective interest rate, an entity shall estimate the expected cash flows by considering all contractual terms of the financial asset (for example, prepayment, extension, call and similar options) and expected credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate (see paragraphs AG156–AG158), transaction costs, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the cash flows or the remaining life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments).

Derecognition is the removal of a previously recognised financial asset or financial liability from an entity's statement of financial position.

A derivative is a financial instrument or other contract within the scope of this Standard with all three of the following characteristics.

(a) **Its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying').**

(b) **It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.**

(c) **It is settled at a future date.**

Dividends or similar distributions are distributions to holders of equity instruments in proportion to their holdings of a particular class of capital.

The effective interest method is the method that is used in the calculation of the amortised cost of a financial asset or a financial liability and in the allocation and recognition of the interest revenue or interest expense in surplus or deficit over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset or to the amortised cost of a financial liability. When calculating the effective interest rate, an entity shall estimate the expected cash flows by considering all the contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) but shall not consider the expected credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate (see paragraphs AG156–AG158), transaction costs, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the cash flows or the expected life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments).

An expected credit loss is the weighted average of credit losses with the respective risks of a default occurring as the weights.

A financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

A financial liability at fair value through surplus or deficit is a financial liability that meets one of the following conditions.

(a) **It meets the definition of held for trading.**

(b) **Upon initial recognition it is designated by the entity as at fair value through surplus or deficit in accordance with paragraph 46 or 51.**

(c) **It is designated either upon initial recognition or subsequently as at fair value through surplus or deficit in accordance with paragraph 152.**

A firm commitment is a binding agreement for the exchange of a specified quantity of resources at a specified price on a specified future date or dates.

A forecast transaction is an uncommitted but anticipated future transaction.

The gross carrying amount of a financial asset is the amortised cost of a financial asset, before adjusting for any loss allowance.

The hedge ratio is the relationship between the quantity of the hedging instrument and the quantity of the hedged item in terms of their relative weighting.

A held for trading financial instrument is a financial asset or financial liability that:

(a) **Is acquired or incurred principally for the purpose of selling or repurchasing it in the near term;**

(b) **On initial recognition is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or**

(c) **Is a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).**

An impairment gain or loss is recognised in surplus or deficit in accordance with paragraph 80 and arises from applying the impairment requirements in paragraphs 73–93.

Lifetime expected credit losses are the expected credit losses that result from all possible default events over the expected life of a financial instrument.

A loss allowance is the allowance for expected credit losses on financial assets measured in accordance with paragraph 40 and lease receivables, the accumulated impairment amount for financial assets measured in accordance with paragraph 41 and the provision for expected credit losses on loan commitments and financial guarantee contracts.

A modification gain or loss is the amount arising from adjusting the gross carrying amount of a financial asset to reflect the renegotiated or modified contractual cash flows. The entity recalculates the gross carrying amount of a financial asset as the present value of the estimated future cash payments or receipts through the expected life of the renegotiated or modified financial asset that are discounted at the financial asset's original effective interest rate (or the original credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets) or, when applicable, the revised effective interest rate calculated in accordance with paragraph 139. When estimating the expected cash flows of a financial asset, an entity shall consider all contractual terms of the financial asset (for example, prepayment, call and similar options) but shall not consider the expected credit losses, unless the financial asset is a purchased or originated credit-impaired financial asset, in which case an entity shall also consider the initial expected credit losses that were considered when calculating the original credit-adjusted effective interest rate.

A financial asset is past due when a counterparty has failed to make a payment when that payment was contractually due.

A purchased or originated credit-impaired financial asset is credit-impaired on initial recognition.

The reclassification date is the first day of the first reporting period following the change in management model that results in an entity reclassifying financial assets.

A regular way purchase or sale is a purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned.

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability (see paragraph AG163). An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.

Terms defined in other PBE Standards are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately. The following terms are defined in either PBE IPSAS 28 or PBE IPSAS 30 *Financial Instruments: Disclosures*: credit risk,[1] currency risk, liquidity risk, market risk, equity instrument, financial asset, financial instrument, financial liability and puttable instrument.

Recognition and Derecognition

Initial Recognition

10. **An entity shall recognise a financial asset or a financial liability in its statement of financial position when, and only when, the entity becomes party to the contractual provisions of the instrument (see paragraphs AG15 and AG16). When an entity first recognises a financial asset, it shall classify it in accordance with paragraphs 39–44 and measure it in accordance with paragraphs 57 and 59. When an entity first recognises a financial liability, it shall classify it in accordance with paragraphs 45 and 46 and measure it in accordance with paragraph 57.**

Regular Way Purchase or Sale of Financial Assets

11. **A regular way purchase or sale of financial assets shall be recognised and derecognised, as applicable, using trade date accounting or settlement date accounting (see paragraphs AG17–AG20).**

Derecognition of Financial Assets

12. In consolidated financial statements, paragraphs 13–20, AG15, AG15 and AG21–AG38 are applied at a consolidated level. Hence, an entity first consolidates all controlled entities in accordance with PBE IPSAS 35 and then applies those paragraphs to the resulting economic entity.

13. **Before evaluating whether, and to what extent, derecognition is appropriate under paragraphs 14–20, an entity determines whether those paragraphs should be applied to a part of a financial asset (or a part of a group of similar financial assets) or a financial asset (or a group of similar financial assets) in its entirety, as follows.**

    (a) **Paragraphs 14–20 are applied to a part of a financial asset (or a part of a group of similar financial assets) if, and only if, the part being considered for derecognition meets one of the following three conditions.**

        (i) **The part comprises only specifically identified cash flows from a financial asset (or a group of similar financial assets). For example, when an entity enters into an interest rate strip whereby the counterparty obtains the right to the interest cash flows, but not the principal cash flows from a debt instrument, paragraphs 14–20 are applied to the interest cash flows.**

        (ii) **The part comprises only a fully proportionate (pro rata) share of the cash flows from a financial asset (or a group of similar financial assets). For example, when an entity enters into an arrangement whereby the counterparty obtains the rights to a 90 per cent share of all cash flows of a debt instrument, paragraphs 14–20 are applied to 90 per cent of those cash flows. If there is more than one counterparty, each**

[1] This term (as defined in PBE IPSAS 30) is used in the requirements for presenting the effects of changes in credit risk on liabilities designated as at fair value through surplus or deficit (see paragraph 107).

counterparty is not required to have a proportionate share of the cash flows provided that the transferring entity has a fully proportionate share.

(iii) **The part comprises only a fully proportionate (pro rata) share of specifically identified cash flows from a financial asset (or a group of similar financial assets). For example, when an entity enters into an arrangement whereby the counterparty obtains the rights to a 90 per cent share of interest cash flows from a financial asset, paragraphs 14–20 are applied to 90 per cent of those interest cash flows. If there is more than one counterparty, each counterparty is not required to have a proportionate share of the specifically identified cash flows provided that the transferring entity has a fully proportionate share.**

(b) **In all other cases, paragraphs 14–20 are applied to the financial asset in its entirety (or to the group of similar financial assets in their entirety). For example, when an entity transfers (i) the rights to the first or the last 90 per cent of cash collections from a financial asset (or a group of financial assets), or (ii) the rights to 90 per cent of the cash flows from a group of receivables, but provides a guarantee to compensate the buyer for any credit losses up to 8 per cent of the principal amount of the receivables, paragraphs 14–20 are applied to the financial asset (or a group of similar financial assets) in its entirety.**

In paragraphs 14–23, the term 'financial asset' refers to either a part of a financial asset (or a part of a group of similar financial assets) as identified in (a) above or, otherwise, a financial asset (or a group of similar financial assets) in its entirety.

14. **An entity shall derecognise a financial asset when, and only when:**

(a) **The contractual rights to the cash flows from the financial asset expire or are waived, or**

(b) **It transfers the financial asset as set out in paragraphs 15 and 16 and the transfer qualifies for derecognition in accordance with paragraph 17.**

(See paragraph 11 for regular way sales of financial assets.)

15. **An entity transfers a financial asset if, and only if, it either:**

(a) **Transfers the contractual rights to receive the cash flows of the financial asset, or**

(b) **Retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients in an arrangement that meets the conditions in paragraph 16.**

16. **When an entity retains the contractual rights to receive the cash flows of a financial asset (the 'original asset'), but assumes a contractual obligation to pay those cash flows to one or more entities (the 'eventual recipients'), the entity treats the transaction as a transfer of a financial asset if, and only if, all of the following three conditions are met.**

(a) **The entity has no obligation to pay amounts to the eventual recipients unless it collects equivalent amounts from the original asset. Short-term advances by the entity with the right of full recovery of the amount lent plus accrued interest at market rates do not violate this condition.**

(b) **The entity is prohibited by the terms of the transfer contract from selling or pledging the original asset other than as security to the eventual recipients for the obligation to pay them cash flows.**

(c) **The entity has an obligation to remit any cash flows it collects on behalf of the eventual recipients without material delay. In addition, the entity is not entitled to reinvest such cash flows, except for investments in cash or cash equivalents (as defined in PBE IPSAS 2 *Cash Flow Statements*) during the short settlement period from the collection date to the date of required remittance to the eventual recipients, and interest earned on such investments is passed to the eventual recipients.**

17. **When an entity transfers a financial asset (see paragraph 15), it shall evaluate the extent to which it retains the risks and rewards of ownership of the financial asset. In this case:**

    (a) **If the entity transfers substantially all the risks and rewards of ownership of the financial asset, the entity shall derecognise the financial asset and recognise separately as assets or liabilities any rights and obligations created or retained in the transfer.**

    (b) **If the entity retains substantially all the risks and rewards of ownership of the financial asset, the entity shall continue to recognise the financial asset.**

    (c) **If the entity neither transfers nor retains substantially all the risks and rewards of ownership of the financial asset, the entity shall determine whether it has retained control of the financial asset. In this case:**

        (i) **If the entity has not retained control, it shall derecognise the financial asset and recognise separately as assets or liabilities any rights and obligations created or retained in the transfer.**

        (ii) **If the entity has retained control, it shall continue to recognise the financial asset to the extent of its continuing involvement in the financial asset (see paragraph 27).**

18. The transfer of risks and rewards (see paragraph 17) is evaluated by comparing the entity's exposure, before and after the transfer, with the variability in the amounts and timing of the net cash flows of the transferred asset. An entity has retained substantially all the risks and rewards of ownership of a financial asset if its exposure to the variability in the present value of the future net cash flows from the financial asset does not change significantly as a result of the transfer (e.g., because the entity has sold a financial asset subject to an agreement to buy it back at a fixed price or the sale price plus a lender's return). An entity has transferred substantially all the risks and rewards of ownership of a financial asset if its exposure to such variability is no longer significant in relation to the total variability in the present value of the future net cash flows associated with the financial asset (e.g., because the entity has sold a financial asset subject only to an option to buy it back at its *fair value* at the time of repurchase or has transferred a fully proportionate share of the cash flows from a larger financial asset in an arrangement, such as a loan sub-participation, that meets the conditions in paragraph 16).

19. Often it will be obvious whether the entity has transferred or retained substantially all risks and rewards of ownership and there will be no need to perform any computations. In other cases, it will be necessary to compute and compare the entity's exposure to the variability in the present value of the future net cash flows before and after the transfer. The computation and comparison are made using as the discount rate an appropriate current market interest rate. All reasonably possible variability in net cash flows is considered, with greater weight being given to those outcomes that are more likely to occur.

20. Whether the entity has retained control (see paragraph 17(c)) of the transferred asset depends on the transferee's ability to sell the asset. If the transferee has the practical ability to sell the asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without needing to impose additional restrictions on the transfer, the entity has not retained control. In all other cases, the entity has retained control.

Transfers that Qualify for Derecognition

21. **If an entity transfers a financial asset in a transfer that qualifies for derecognition in its entirety and retains the right to service the financial asset for a fee, it shall recognise either a servicing asset or a servicing liability for that servicing contract. If the fee to be received is not expected to compensate the entity adequately for performing the servicing, a servicing liability for the servicing obligation shall be recognised at its fair value. If the fee to be received is expected to be more than adequate compensation for the servicing, a servicing asset shall be recognised for the servicing right at an amount determined on the basis of an allocation of the carrying amount of the larger financial asset in accordance with paragraph 24.**

22. **If, as a result of a transfer, a financial asset is derecognised in its entirety but the transfer results in the entity obtaining a new financial asset or assuming a new financial liability, or a servicing liability, the entity shall recognise the new financial asset, financial liability or servicing liability at fair value.**

23. **On derecognition of a financial asset in its entirety, the difference between:**

    (a) **The carrying amount (measured at the date of derecognition); and**

    (b) **The consideration received (including any new asset obtained less any new liability assumed)**

    shall be recognised in surplus or deficit.

24. **If the transferred asset is part of a larger financial asset (e.g., when an entity transfers interest cash flows that are part of a debt instrument, see paragraph 13(a)) and the part transferred qualifies for derecognition in its entirety, the previous carrying amount of the larger financial asset shall be allocated between the part that continues to be recognised and the part that is derecognised, on the basis of the relative fair values of those parts on the date of the transfer. For this purpose, a retained servicing asset shall be treated as a part that continues to be recognised. The difference between:**

    (a) **The carrying amount (measured at the date of derecognition) allocated to the part derecognised; and**

    (b) **The consideration received for the part derecognised (including any new asset obtained less any new liability assumed)**

    shall be recognised in surplus or deficit.

25. When an entity allocates the previous carrying amount of a larger financial asset between the part that continues to be recognised and the part that is derecognised, the fair value of the part that continues to be recognised needs to be measured. When the entity has a history of selling parts similar to the part that continues to be recognised or other market transactions exist for such parts, recent prices of actual transactions provide the best estimate of its fair value. When there are no price quotes or recent market transactions to support the fair value of the part that continues to be recognised, the best estimate of the fair value is the difference between the fair value of the larger financial asset as a whole and the consideration received from the transferee for the part that is derecognised.

Transfers that do not Qualify for Derecognition

26. **If a transfer does not result in derecognition because the entity has retained substantially all the risks and rewards of ownership of the transferred asset, the entity shall continue to recognise the transferred asset in its entirety and shall recognise a financial liability for the consideration received. In subsequent periods, the entity shall recognise any revenue on the transferred asset and any expense incurred on the financial liability.**

Continuing Involvement in Transferred Assets

27. **If an entity neither transfers nor retains substantially all the risks and rewards of ownership of a transferred asset, and retains control of the transferred asset, the entity continues to recognise the transferred asset to the extent of its continuing involvement. The extent of the entity's continuing involvement in the transferred asset is the extent to which it is exposed to changes in the value of the transferred asset. For example:**

    (a) **When the entity's continuing involvement takes the form of guaranteeing the transferred asset, the extent of the entity's continuing involvement is the lower of (i) the amount of the asset and (ii) the maximum amount of the consideration received that the entity could be required to repay ('the guarantee amount').**

    (b) **When the entity's continuing involvement takes the form of a written or purchased option (or both) on the transferred asset, the extent of the entity's continuing involvement is the amount of the transferred asset that the entity may repurchase. However, in the case of a written put option on an asset that is measured at fair value, the extent of the entity's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price (see paragraph AG34).**

    (c) **When the entity's continuing involvement takes the form of a cash-settled option or similar provision on the transferred asset, the extent of the entity's continuing involvement is measured in the same way as that which results from non-cash settled options as set out in (b) above.**

28. **When an entity continues to recognise an asset to the extent of its continuing involvement, the entity also recognises an associated liability. Despite the other measurement requirements in this Standard, the transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the entity has retained. The associated liability is measured in such a way that the net carrying amount of the transferred asset and the associated liability is:**

    (a) **The amortised cost of the rights and obligations retained by the entity, if the transferred asset is measured at amortised cost, or**

    (b) **Equal to the fair value of the rights and obligations retained by the entity when measured on a stand-alone basis, if the transferred asset is measured at fair value.**

29. **The entity shall continue to recognise any revenue arising on the transferred asset to the extent of its continuing involvement and shall recognise any expense incurred on the associated liability.**

30. **For the purpose of subsequent measurement, recognised changes in the fair value of the transferred asset and the associated liability are accounted for consistently with each other in accordance with paragraph 101, and shall not be offset.**

31. **If an entity's continuing involvement is in only a part of a financial asset (e.g., when an entity retains an option to repurchase part of a transferred asset, or retains a residual interest that does not result in the retention of substantially all the risks and rewards of ownership and the entity retains control), the entity allocates the previous carrying amount of the financial asset between the part it continues to recognise under continuing involvement, and the part it no longer recognises on the basis of the relative fair values of those parts on the date of the transfer. For this purpose, the requirements of paragraph 25 apply. The difference between:**

    (a) **The carrying amount (measured at the date of derecognition) allocated to the part that is no longer recognised; and**

    (b) **The consideration received for the part no longer recognised**

    shall be recognised in surplus or deficit.

32. If the transferred asset is measured at amortised cost, the option in this Standard to designate a financial liability as at fair value through surplus or deficit is not applicable to the associated liability.

All Transfers

33. **If a transferred asset continues to be recognised, the asset and the associated liability shall not be offset. Similarly, the entity shall not offset any revenue arising from the transferred asset with any expense incurred on the associated liability (see paragraph 47 of PBE IPSAS 28).**

34. **If a transferor provides non-cash collateral (such as debt or equity instruments) to the transferee, the accounting for the collateral by the transferor and the transferee depends on whether the transferee has the right to sell or repledge the collateral and on whether the transferor has defaulted. The transferor and transferee shall account for the collateral as follows:**

    (a) **If the transferee has the right by contract or custom to sell or repledge the collateral, then the transferor shall reclassify that asset in its statement of financial position (e.g., as a loaned asset, pledged equity instruments or repurchase receivable) separately from other assets.**

    (b) **If the transferee sells collateral pledged to it, it shall recognise the proceeds from the sale and a liability measured at fair value for its obligation to return the collateral.**

    (c) **If the transferor defaults under the terms of the contract and is no longer entitled to redeem the collateral, it shall derecognise the collateral, and the transferee shall recognise the collateral as its asset initially measured at fair value or, if it has already sold the collateral, derecognise its obligation to return the collateral.**

    (d) **Except as provided in (c), the transferor shall continue to carry the collateral as its asset, and the transferee shall not recognise the collateral as an asset.**

Derecognition of Financial Liabilities

35. **An entity shall remove a financial liability (or a part of a financial liability) from its statement of financial position when, and only when, it is extinguished—i.e., when the obligation specified in the contract is discharged, waived, cancelled or expires.**

36. **An exchange between an existing borrower and lender of debt instruments with substantially different terms shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. Similarly, a substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.**

37. **The difference between the carrying amount of a financial liability (or part of a financial liability) extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, shall be recognised in surplus or deficit. Where an obligation is waived by the lender or assumed by a third party as part of a non-exchange transaction, an entity applies PBE IPSAS 23.**

38. If an entity repurchases a part of a financial liability, the entity shall allocate the previous carrying amount of the financial liability between the part that continues to be recognised and the part that is derecognised based on the relative fair values of those parts on the date of the repurchase. The difference between (a) the carrying amount allocated to the part derecognised and (b) the consideration paid, including any non-cash assets transferred or liabilities assumed, for the part derecognised shall be recognised in surplus or deficit.

Classification

Classification of Financial Assets

39. **Unless paragraph 44 applies, an entity shall classify financial assets as subsequently measured at amortised cost, fair value through other comprehensive revenue and expense or fair value through surplus or deficit on the basis of both:**

    (a) **The entity's management model for financial assets and**

    (b) **The contractual cash flow characteristics of the financial asset.**

40. **A financial asset shall be measured at amortised cost if both of the following conditions are met:**

    (a) **The financial asset is held within a management model whose objective is to hold financial assets in order to collect contractual cash flows and**

    (b) **The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.**

    Paragraphs AG48–AG88 provide guidance on how to apply these conditions.

41. **A financial asset shall be measured at fair value through other comprehensive revenue and expense if both of the following conditions are met:**

    (a) **The financial asset is held within a management model whose objective is achieved by both collecting contractual cash flows and selling financial assets and**

    (b) **The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.**

    Paragraphs AG48–AG88 provide guidance on how to apply these conditions.

42. **For the purpose of applying paragraphs 40(b) and 41(b):**

    (a) **Principal is the fair value of the financial asset at initial recognition. Paragraph AG64 provides additional guidance on the meaning of principal.**

    (b) **Interest consists of consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs, as well as a profit margin. Paragraphs AG63 and AG67–AG71 provide**

additional guidance on the meaning of interest, including the meaning of the time value of money.

43. **A financial asset shall be measured at fair value through surplus or deficit unless it is measured at amortised cost in accordance with paragraph 40 or at fair value through other comprehensive revenue and expense in accordance with paragraph 41. However, an entity may make an irrevocable election at initial recognition for particular investments in equity instruments that would otherwise be measured at fair value through surplus or deficit to present subsequent changes in fair value in other comprehensive revenue and expense (see paragraphs 106–107).**

Option to Designate a Financial Asset at Fair Value Through Surplus or Deficit

44. **Despite paragraphs 39–43, an entity may, at initial recognition, irrevocably designate a financial asset as measured at fair value through surplus or deficit if doing so eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases (see paragraphs AG91–AG94).**

Classification of Financial Liabilities

45. **An entity shall classify all financial liabilities as subsequently measured at amortised cost, except for:**

    (a) **Financial liabilities at fair value through surplus or deficit. Such liabilities, including derivatives that are liabilities, shall be subsequently measured at fair value.**

    (b) **Financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies. Paragraphs 26 and 28 apply to the measurement of such financial liabilities.**

    (c) **Financial guarantee contracts. After initial recognition, an issuer of such a contract shall (unless paragraph 45(a) or (b) applies) subsequently measure it at the higher of:**

        (i) **The amount of the loss allowance determined in accordance with paragraphs 73–93; and**

        (ii) **The amount initially recognised (see paragraph 57) less, when appropriate, the cumulative amount of amortisation recognised in accordance with the principles of PBE IPSAS 9.**

    (d) **Commitments to provide a loan at a below-market interest rate. An issuer of such a commitment shall (unless paragraph 45(a) applies) subsequently measure it at the higher of:**

        (i) **The amount of the loss allowance determined in accordance with paragraphs 73–93; and**

        (ii) **The amount initially recognised (see paragraph 57) less, when appropriate, the cumulative amount of amortisation recognised in accordance with the principles of PBE IPSAS 9.**

    (e) **Contingent consideration recognised by an acquirer in a business combination to which PBE IFRS 3 applies. Such contingent consideration shall subsequently be measured at fair value with changes recognised in surplus or deficit.**

Option to Designate a Financial Liability at Fair Value Through Surplus or Deficit

46. **An entity may, at initial recognition, irrevocably designate a financial liability as measured at fair value through surplus or deficit when permitted by paragraph 51, or when doing so results in more relevant information, because either:**

    (a) **It eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as 'an accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases (see paragraphs AG91–AG94); or**

(b) **A group of financial liabilities or financial assets and financial liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel (as defined in PBE IPSAS 20 *Related Party Disclosures*), for example, the entity's governing body and chief executive officer (see paragraphs AG95–AG98).**

Embedded Derivatives

47. An embedded derivative is a component of a hybrid contract that also includes a non-derivative host—with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract. A derivative that is attached to a *financial instrument* but is contractually transferable independently of that instrument, or has a different counterparty, is not an embedded derivative, but a separate financial instrument.

Hybrid Contracts with Financial Asset Hosts

48. **If a hybrid contract contains a host that is an asset within the scope of this Standard, an entity shall apply the requirements in paragraphs 39–44 to the entire hybrid contract.**

Other Hybrid Contracts

49. **If a hybrid contract contains a host that is not an asset within the scope of this Standard, an embedded derivative shall be separated from the host and accounted for as a derivative under this Standard if, and only if:**

    (a) **The economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host (see paragraphs AG103 and AG106);**

    (b) **A separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and**

    (c) **The hybrid contract is not measured at fair value with changes in fair value recognised in surplus or deficit (i.e., a derivative that is embedded in a financial liability at fair value through surplus or deficit is not separated).**

50. **If an embedded derivative is separated, the host contract shall be accounted for in accordance with the appropriate Standards. This Standard does not address whether an embedded derivative shall be presented separately in the statement of financial position.**

51. **Despite paragraphs 49 and 50, if a contract contains one or more embedded derivatives and the host is not an asset within the scope of this Standard, an entity may designate the entire hybrid contract as at fair value through surplus or deficit unless:**

    (a) **The embedded derivative(s) do(es) not significantly modify the cash flows that otherwise would be required by the contract; or**

    (b) **It is clear with little or no analysis when a similar hybrid instrument is first considered that separation of the embedded derivative(s) is prohibited, such as a prepayment option embedded in a loan that permits the holder to prepay the loan for approximately its amortised cost.**

52. **If an entity is required by this Standard to separate an embedded derivative from its host, but is unable to measure the embedded derivative separately either at acquisition or at the end of a subsequent financial reporting period, it shall designate the entire hybrid contract as at fair value through surplus or deficit.**

53. If an entity is unable to measure reliably the fair value of an embedded derivative on the basis of its terms and conditions, the fair value of the embedded derivative is the difference between the fair value of the hybrid contract and the fair value of the host. If the entity is unable to measure the fair value of the

embedded derivative using this method, paragraph 52 applies and the hybrid contract is designated as at fair value through surplus or deficit.

Reclassification

54. **When, and only when, an entity changes its management model financial assets it shall reclassify all affected financial assets in accordance with paragraphs 39–43. See paragraphs 94–100, AG111–AG113 and AG220–AG221 for additional guidance on reclassifying financial assets.**

55. **An entity shall not reclassify any financial liability.**

56. The following changes in circumstances are not reclassifications for the purposes of paragraphs 54–55:

    (a) An item that was previously a designated and effective hedging instrument in a cash flow hedge or net investment hedge no longer qualifies as such;

    (b) An item becomes a designated and effective hedging instrument in a cash flow hedge or net investment hedge; and

    (c) Changes in measurement in accordance with paragraphs 152–155.

Measurement

Initial Measurement

57. **Except for short-term receivables and payables within the scope of paragraph 60, at initial recognition, an entity shall measure a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through surplus or deficit, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.**

58. **However, if the fair value of the financial asset or financial liability at initial recognition differs from the transaction price, an entity shall apply paragraph AG117.**

59. When an entity uses settlement date accounting for an asset that is subsequently measured at amortised cost, the asset is recognised initially at its fair value on the trade date (see paragraphs AG17–AG20).

60. Despite the requirement in paragraph 57, at initial recognition, an entity may measure short-term receivables and payables at the original invoice amount if the effect of discounting is immaterial.

Subsequent Measurement of Financial Assets

61. **After initial recognition, an entity shall measure a financial asset in accordance with paragraphs 39- 44 at:**

    (a) **Amortised cost;**

    (b) **Fair value through other comprehensive revenue and expense; or**

    (c) **Fair value through surplus or deficit.**

62. **An entity shall apply the impairment requirements in 73–93 to financial assets that are measured at amortised cost in accordance with paragraph 40 and to financial assets that are measured at fair value through other comprehensive revenue and expense in accordance with paragraph 41.**

63. **An entity shall apply the hedge accounting requirements in paragraphs 137–143 (and, if applicable, paragraphs 99–105 of PBE IPSAS 29 *Financial Instruments: Recognition and Measurement* for the fair value hedge accounting for a portfolio hedge of interest rate risk) to a financial asset that is designated as a hedged item.**[2]

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[2] In accordance with paragraph 178, an entity may choose as its accounting policy to continue to apply the hedge accounting requirements in PBE IPSAS 29 instead of the requirements in paragraphs 113–155 of this Standard. If an entity has made this election, the references in this Standard to particular hedge accounting requirements in paragraphs 113–155 are not relevant. Instead the entity applies the relevant hedge accounting requirements in PBE IPSAS 29.

Subsequent Measurement of Financial Liabilities

64. **After initial recognition, an entity shall measure a financial liability in accordance with paragraphs 45–46.**

65. **An entity shall apply the hedge accounting requirements in paragraphs 137–143 (and, if applicable, paragraphs 99–105 of PBE IPSAS 29 for the fair value hedge accounting for a portfolio hedge of interest rate risk) to a financial liability that is designated as a hedged item.**

Fair Value Measurement Considerations

66. In determining the fair value of a financial asset or a financial liability for the purpose of applying this Standard, PBE IPSAS 28 or PBE IPSAS 30, an entity shall apply paragraphs AG144–AG155 of Appendix A.

67. The best evidence of fair value is quoted prices in an active market. If the market for a financial instrument is not active, an entity establishes fair value by using a valuation technique. The objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal operating business considerations. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, if available, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the entity uses that technique. The chosen valuation technique makes maximum use of market inputs and relies as little as possible on entity-specific inputs. It incorporates all factors that market participants would consider in setting a price and is consistent with accepted economic methodologies for pricing financial instruments. Periodically, an entity calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on any available observable market data.

68. The fair value of a financial liability with a demand feature (e.g., a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

Amortised Cost Measurement

Financial Assets

Effective Interest Method

69. **Interest revenue shall be calculated by using the effective interest method (see paragraphs 9 and AG156–AG162). This shall be calculated by applying the effective interest rate to the gross carrying amount of a financial asset except for:**

    (a) **Purchased or originated credit-impaired financial assets. For those financial assets, the entity shall apply the credit-adjusted effective interest rate to the amortised cost of the financial asset from initial recognition.**

    (b) **Financial assets that are not purchased or originated credit-impaired financial assets but subsequently have become credit-impaired financial assets. For those financial assets, the entity shall apply the effective interest rate to the amortised cost of the financial asset in subsequent reporting periods.**

70. An entity that, in a reporting period, calculates interest revenue by applying the effective interest method to the amortised cost of a financial asset in accordance with paragraph 69(b), shall, in subsequent reporting periods, calculate the interest revenue by applying the effective interest rate to the gross carrying amount if the credit risk on the financial instrument improves so that the financial asset is no longer credit-impaired and the improvement can be related objectively to an event occurring after the requirements in paragraph 69(b) were applied (such as an improvement in the borrower's credit rating).

Modification of Contractual Cash Flows

71. When the contractual cash flows of a financial asset are renegotiated or otherwise modified and the renegotiation or modification does not result in the derecognition of that financial asset in accordance with

this Standard, an entity shall recalculate the gross carrying amount of the financial asset and shall recognise a modification gain or loss in surplus or deficit. The gross carrying amount of the financial asset shall be recalculated as the present value of the renegotiated or modified contractual cash flows that are discounted at the financial asset's original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets) or, when applicable, the revised effective interest rate calculated in accordance with paragraph 139. Any costs or fees incurred adjust the carrying amount of the modified financial asset and are amortised over the remaining term of the modified financial asset.

Write-off

72. **An entity shall directly reduce the gross carrying amount of a financial asset when the entity has no reasonable expectations of recovering a financial asset in its entirety or a portion thereof. A write-off constitutes a derecognition event (see paragraph AG37(r)).**

Impairment

Recognition of Expected Credit Losses

General Approach

73. **An entity shall recognise a loss allowance for expected credit losses on a financial asset that is measured in accordance with paragraphs 40 or 41 , a lease receivable, or a loan commitment and a financial guarantee contract to which the impairment requirements apply in accordance with paragraphs 2(g), 45(c) or 45(d).**

74. An entity shall apply the impairment requirements for the recognition and measurement of a loss allowance for financial assets that are measured at fair value through other comprehensive revenue and expense in accordance with paragraph 41. However, the loss allowance shall be recognised in other comprehensive revenue and expense and shall not reduce the carrying amount of the financial asset in the statement of financial position.

75. **Subject to paragraphs 85–88, at each reporting date, an entity shall measure the loss allowance for a financial instrument at an amount equal to the lifetime expected credit losses if the credit risk on that financial instrument has increased significantly since initial recognition.**

76. The objective of the impairment requirements is to recognise lifetime expected credit losses for all financial instruments for which there have been significant increases in credit risk since initial recognition — whether assessed on an individual or collective basis — considering all reasonable and supportable information, including that which is forward-looking.

77. **Subject to paragraphs 85–88, if, at the reporting date, the credit risk on a financial instrument has not increased significantly since initial recognition, an entity shall measure the loss allowance for that financial instrument at an amount equal to 12-month expected credit losses.**

78. For loan commitments and financial guarantee contracts, the date that the entity becomes a party to the irrevocable commitment shall be considered to be the date of initial recognition for the purposes of applying the impairment requirements.

79. If an entity has measured the loss allowance for a financial instrument at an amount equal to lifetime expected credit losses in the previous reporting period, but determines at the current reporting date that paragraph 75 is no longer met, the entity shall measure the loss allowance at an amount equal to 12-month expected credit losses at the current reporting date.

80. An entity shall recognise in surplus or deficit, as an impairment gain or loss, the amount of expected credit losses (or reversal) that is required to adjust the loss allowance at the reporting date to the amount that is required to be recognised in accordance with this Standard.

Determining Significant Increases in Credit Risk

81. At each reporting date, an entity shall assess whether the credit risk on a financial instrument has increased significantly since initial recognition. When making the assessment, an entity shall use the change in the risk of a default occurring over the expected life of the financial instrument instead of the change in the amount of expected credit losses. To make that assessment, an entity shall compare the risk of a default occurring on the financial instrument as at the reporting date with the risk of a default occurring on the

financial instrument as at the date of initial recognition and consider reasonable and supportable information, that is available without undue cost or effort, that is indicative of significant increases in credit risk since initial recognition.

82. An entity may assume that the credit risk on a financial instrument has not increased significantly since initial recognition if the financial instrument is determined to have low credit risk at the reporting date (see paragraphs AG186–AG188).

83. If reasonable and supportable forward-looking information is available without undue cost or effort, an entity cannot rely solely on past due information when determining whether credit risk has increased significantly since initial recognition. However, when information that is more forward-looking than past due status (either on an individual or a collective basis) is not available without undue cost or effort, an entity may use past due information to determine whether there have been significant increases in credit risk since initial recognition. Regardless of the way in which an entity assesses significant increases in credit risk, there is a rebuttable presumption that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due. An entity can rebut this presumption if the entity has reasonable and supportable information that is available without undue cost or effort, that demonstrates that the credit risk has not increased significantly since initial recognition even though the contractual payments are more than 30 days past due. When an entity determines that there have been significant increases in credit risk before contractual payments are more than 30 days past due, the rebuttable presumption does not apply.

Modified Financial Assets

84. If the contractual cash flows on a financial asset have been renegotiated or modified and the financial asset was not derecognised, an entity shall assess whether there has been a significant increase in the credit risk of the financial instrument in accordance with paragraph 75 by comparing:

(a) The risk of a default occurring at the reporting date (based on the modified contractual terms); and

(b) The risk of a default occurring at initial recognition (based on the original, unmodified contractual terms).

Purchased or Originated Credit-Impaired Financial Assets

85. **Despite paragraphs 75 and 77, at the reporting date, an entity shall only recognise the cumulative changes in lifetime expected credit losses since initial recognition as a loss allowance for purchased or originated credit-impaired financial assets.**

86. At each reporting date, an entity shall recognise in surplus or deficit the amount of the change in lifetime expected credit losses as an impairment gain or loss. An entity shall recognise favourable changes in lifetime expected credit losses as an impairment gain, even if the lifetime expected credit losses are less than the amount of expected credit losses that were included in the estimated cash flows on initial recognition.

Simplified Approach for Receivables

87. **Despite paragraphs 75 and 77, an entity shall always measure the loss allowance at an amount equal to lifetime expected credit losses for:**

(a) **Receivables that result from exchange transactions that are within the scope of PBE IPSAS 9 and non-exchange transactions within the scope of PBE IPSAS 23.**

(b) **Lease receivables that result from transactions that are within the scope of PBE IPSAS 13, if the entity chooses as its accounting policy to measure the loss allowance at an amount equal to lifetime expected credit losses. That accounting policy shall be applied to all lease receivables but may be applied separately to finance and operating lease receivables.**

88. An entity may select its accounting policy for trade receivables and lease receivables independently of each other.

89. The requirements for purchased or originated credit-impaired financial assets (see paragraphs 9 and 85 to 86) do not apply to short-term receivables.

Measurement of Expected Credit Losses

90. **An entity shall measure expected credit losses of a financial instrument in a way that reflects:**

    (a) **An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;**

    (b) **The time value of money; and**

    (c) **Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.**

91. When measuring expected credit losses, an entity need not necessarily identify every possible scenario. However, it shall consider the risk or probability that a credit loss occurs by reflecting the possibility that a credit loss occurs and the possibility that no credit loss occurs, even if the possibility of a credit loss occurring is very low.

92. The maximum period to consider when measuring expected credit losses is the maximum contractual period (including extension options) over which the entity is exposed to credit risk and not a longer period, even if that longer period is consistent with business practice.

93. However, some financial instruments include both a loan and an undrawn commitment component and the entity's contractual ability to demand repayment and cancel the undrawn commitment does not limit the entity's exposure to credit losses to the contractual notice period. For such financial instruments, and only those financial instruments, the entity shall measure expected credit losses over the period that the entity is exposed to credit risk and expected credit losses would not be mitigated by credit risk management actions, even if that period extends beyond the maximum contractual period.

Reclassification of Financial Assets

94. **If an entity reclassifies financial assets in accordance with paragraph 54, it shall apply the reclassification prospectively from the reclassification date. The entity shall not restate any previously recognised gains, losses (including impairment gains or losses) or interest. Paragraphs 95–100 set out the requirements for reclassifications.**

95. **If an entity reclassifies a financial asset out of the amortised cost measurement category and into the fair value through surplus or deficit measurement category, its fair value is measured at the reclassification date. Any gain or loss arising from a difference between the previous amortised cost of the financial asset and fair value is recognised in surplus or deficit.**

96. **If an entity reclassifies a financial asset out of the fair value through surplus or deficit measurement category and into the amortised cost measurement category, its fair value at the reclassification date becomes its new gross carrying amount. (See paragraph AG221 for guidance on determining an effective interest rate and a loss allowance at the reclassification date.)**

97. **If an entity reclassifies a financial asset out of the amortised cost measurement category and into the fair value through other comprehensive revenue and expense measurement category, its fair value is measured at the reclassification date. Any gain or loss arising from a difference between the previous amortised cost of the financial asset and fair value is recognised in other comprehensive revenue and expense. The effective interest rate and the measurement of expected credit losses are not adjusted as a result of the reclassification. (See paragraph AG220.)**

98. **If an entity reclassifies a financial asset out of the fair value through other comprehensive revenue and expense measurement category and into the amortised cost measurement category, the financial asset is reclassified at its fair value at the reclassification date. However, the cumulative gain or loss previously recognised in other comprehensive revenue and expense is removed from net assets/equity and adjusted against the fair value of the financial asset at the reclassification date. As a result, the financial asset is measured at the reclassification date as if it had always been measured at amortised cost. This adjustment affects other comprehensive revenue and expense but does not affect surplus or deficit and therefore is not a reclassification adjustment (see PBE IPSAS 1 *Presentation of Financial Reports*). The effective interest rate and the measurement of expected credit losses are not adjusted as a result of the reclassification. (See paragraph AG220.)**

99. **If an entity reclassifies a financial asset out of the fair value through surplus or deficit measurement category and into the fair value through other comprehensive revenue and expense measurement category, the financial asset continues to be measured at fair value. (See paragraph AG221 for guidance on determining an effective interest rate and a loss allowance at the reclassification date.)**

100. **If an entity reclassifies a financial asset out of the fair value through other comprehensive revenue and expense measurement category and into the fair value through surplus or deficit measurement category, the financial asset continues to be measured at fair value. The cumulative gain or loss previously recognised in other comprehensive revenue and expense is reclassified from net assets/equity to surplus or deficit as a reclassification adjustment (see PBE IPSAS 1) at the reclassification date.**

Gains and Losses

101. **A gain or loss on a financial asset or financial liability that is measured at fair value shall be recognised in surplus or deficit unless:**

(a) **It is part of a hedging relationship (see paragraphs 137–143 and, if applicable, paragraphs 99- 105 of PBE IPSAS 29 for the fair value hedge accounting for a portfolio hedge of interest rate risk);**

(b) **It is an investment in an equity instrument and the entity has elected to present gains and losses on that investment in other comprehensive revenue and expense in accordance with paragraph 106;**

(c) **It is a financial liability designated as at fair value through surplus or deficit and the entity is required to present the effects of changes in the liability's credit risk in other comprehensive revenue and expense in accordance with paragraph 108; or**

(d) **It is a financial asset measured at fair value through other comprehensive revenue and expense in accordance with paragraph 41 and the entity is required to recognise some changes in fair value in other comprehensive revenue and expense in accordance with paragraph 111.**

102. Dividends or similar distributions are recognised in surplus or deficit only when:

(a) The entity's right to receive payment of the dividend is established;

(b) It is probable that the economic benefits associated with the dividend will flow to the entity; and

(c) The amount of the dividend can be measured reliably.

103. **A gain or loss on a financial asset that is measured at amortised cost and is not part of a hedging relationship (see paragraphs 137–143 and, if applicable, paragraphs 99–105 of PBE IPSAS 29 for the fair value hedge accounting for a portfolio hedge of interest rate risk) shall be recognised in surplus or deficit when the financial asset is derecognised, reclassified in accordance with paragraph 95, through the amortisation process or in order to recognise impairment gains or losses. An entity shall apply paragraphs 95 and 97 if it reclassifies financial assets out of the amortised cost measurement category. A gain or loss on a financial liability that is measured at amortised cost and is not part of a hedging relationship (see paragraphs 137–143 and, if applicable, paragraphs 99–105 of PBE IPSAS 29 for the fair value hedge accounting for a portfolio hedge of interest rate risk) shall be recognised in surplus or deficit when the financial liability is derecognised and through the amortisation process. (See paragraph AG224 for guidance on foreign exchange gains or losses.)**

104. **A gain or loss on financial assets or financial liabilities that are hedged items in a hedging relationship shall be recognised in accordance with paragraphs 137–143 and, if applicable, paragraphs 99–105 of PBE IPSAS 29 for the fair value hedge accounting for a portfolio hedge of interest rate risk.**

105. **If an entity recognises financial assets using settlement date accounting (see paragraphs 11, AG17 and AG20), any change in the fair value of the asset to be received during the period between the trade date and the settlement date is not recognised for assets measured at amortised cost. For assets measured at fair value, however, the change in fair value shall be recognised in surplus or deficit or in other comprehensive revenue and expense, as appropriate in accordance with paragraph 101. The**

trade date shall be considered the date of initial recognition for the purposes of applying the impairment requirements.

Investments in Equity Instruments

106. **At initial recognition, an entity may make an irrevocable election to present in other comprehensive revenue and expense subsequent changes in the fair value of an investment in an equity instrument within the scope of this Standard that is neither held for trading nor contingent consideration recognised by an acquirer in a business combination to which PBE IFRS 3 applies. (See paragraph AG226 for guidance on foreign exchange gains or losses.)**

107. If an entity makes the election in paragraph 106, it shall recognise in surplus or deficit dividends or similar distributions from that investment in accordance with paragraph 102.

Liabilities Designated as at Fair Value Through Surplus or Deficit

108. **An entity shall present a gain or loss on a financial liability that is designated as at fair value through surplus or deficit in accordance with paragraph 46 or paragraph 51 as follows:**

   (a) **The amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability shall be presented in other comprehensive revenue and expense (see paragraphs AG236–AG243), and**

   (b) **The remaining amount of change in the fair value of the liability shall be presented in surplus or deficit**

   unless the treatment of the effects of changes in the liability's credit risk described in (a) would create or enlarge an accounting mismatch in surplus or deficit (in which case paragraph 109 applies). Paragraphs AG228–AG230 and AG233–AG235 provide guidance on determining whether an accounting mismatch would be created or enlarged.

109. **If the requirements in paragraph 108 would create or enlarge an accounting mismatch in surplus or deficit, an entity shall present all gains or losses on that liability (including the effects of changes in the credit risk of that liability) in surplus or deficit.**

110. Despite the requirements in paragraphs 108 and 109, an entity shall present in surplus or deficit all gains and losses on loan commitments and financial guarantee contracts that are designated as at fair value through surplus or deficit.

Assets Measured at Fair Value Through Other Comprehensive Revenue and Expense

111. **A gain or loss on a financial asset measured at fair value through other comprehensive revenue and expense in accordance with paragraph 41 shall be recognised in other comprehensive revenue and expense, except for impairment gains or losses (see paragraphs 73–93) and foreign exchange gains and losses (see paragraphs AG224–AG225), until the financial asset is derecognised or reclassified. When the financial asset is derecognised the cumulative gain or loss previously recognised in other comprehensive revenue and expense is reclassified from net assets/equity to surplus or deficit as a reclassification adjustment (see PBE IPSAS 1). If the financial asset is reclassified out of the fair value through other comprehensive revenue and expense measurement category, the entity shall account for the cumulative gain or loss that was previously recognised in other comprehensive revenue and expense in accordance with paragraphs 98 and 100. Interest calculated using the effective interest method is recognised in surplus or deficit.**

112. **As described in paragraph 111, if a financial asset is measured at fair value through other comprehensive revenue and expense in accordance with paragraph 41, the amounts that are recognised in surplus or deficit are the same as the amounts that would have been recognised in surplus or deficit if the financial asset had been measured at amortised cost.**

Hedge Accounting

Objective and Scope of Hedge Accounting

113. The objective of hedge accounting is to represent, in the financial statements, the effect of an entity's risk management activities that use financial instruments to manage exposures arising from particular risks that

could affect surplus or deficit (or other comprehensive revenue and expense, in the case of investments in equity instruments for which an entity has elected to present changes in fair value in other comprehensive revenue and expense in accordance with paragraph 106). This approach aims to convey the context of hedging instruments for which hedge accounting is applied in order to allow insight into their purpose and effect.

114. An entity may choose to designate a hedging relationship between a hedging instrument and a hedged item in accordance with paragraphs 116–128 and AG244–AG274. For hedging relationships that meet the qualifying criteria, an entity shall account for the gain or loss on the hedging instrument and the hedged item in accordance with paragraphs 130–143 and AG294–AG321. When the hedged item is a group of items, an entity shall comply with the additional requirements in paragraphs 146–151 and AG333–AG348.

115. For a fair value hedge of the interest rate exposure of a portfolio of financial assets or financial liabilities (and only for such a hedge), an entity may apply the hedge accounting requirements in PBE IPSAS 29 instead of those in this Standard. In that case, the entity must also apply the specific requirements for the fair value hedge accounting for a portfolio hedge of interest rate risk and designate as the hedged item a portion that is a currency amount (see paragraphs 91, 100 and AG157–AG175 of PBE IPSAS 29).

Hedging Instruments

Qualifying Instruments

116. **A derivative measured at fair value through surplus or deficit may be designated as a hedging instrument, except for some written options (see paragraph AG247).**

117. **A non-derivative financial asset or a non-derivative financial liability measured at fair value through surplus or deficit may be designated as a hedging instrument unless it is a financial liability designated as at fair value through surplus or deficit for which the amount of its change in fair value that is attributable to changes in the credit risk of that liability is presented in other comprehensive revenue and expense in accordance with paragraph 108. For a hedge of foreign currency risk, the foreign currency risk component of a non-derivative financial asset or a non-derivative financial liability may be designated as a hedging instrument provided that it is not an investment in an equity instrument for which an entity has elected to present changes in fair value in other comprehensive revenue and expense in accordance with paragraph 106.**

118. **For hedge accounting purposes, only contracts with a party external to the reporting entity (i.e., external to the economic entity or individual entity that is being reported on) can be designated as hedging instruments.**

Designation of Hedging Instruments

119. A qualifying instrument must be designated in its entirety as a hedging instrument. The only exceptions permitted are:

(a) Separating the intrinsic value and time value of an option contract and designating as the hedging instrument only the change in intrinsic value of an option and not the change in its time value (see paragraphs 144 and AG322–AG326);

(b) Separating the forward element and the spot element of a forward contract and designating as the hedging instrument only the change in the value of the spot element of a forward contract and not the forward element; similarly, the foreign currency basis spread may be separated and excluded from the designation of a financial instrument as the hedging instrument (see paragraphs 145 and AG327–AG332); and

(c) A proportion of the entire hedging instrument, such as 50 per cent of the nominal amount, may be designated as the hedging instrument in a hedging relationship. However, a hedging instrument may not be designated for a part of its change in fair value that results from only a portion of the time period during which the hedging instrument remains outstanding.

120. An entity may view in combination, and jointly designate as the hedging instrument, any combination of the following (including those circumstances in which the risk or risks arising from some hedging instruments offset those arising from others):

(a) Derivatives or a proportion of them; and

(b) Non-derivatives or a proportion of them.

121. However, a derivative instrument that combines a written option and a purchased option (for example, an interest rate collar) does not qualify as a hedging instrument if it is, in effect, a net written option at the date of designation (unless it qualifies in accordance with paragraph AG247). Similarly, two or more instruments (or proportions of them) may be jointly designated as the hedging instrument only if, in combination, they are not, in effect, a net written option at the date of designation (unless it qualifies in accordance with paragraph AG247).

Hedged Items

Qualifying Items

122. **A hedged item can be a recognised asset or liability, an unrecognised firm commitment, a forecast transaction or a net investment in a foreign operation. The hedged item can be:**

(a) **A single item; or**

(b) **A group of items (subject to paragraphs 146–151 and AG333–AG348).**

A hedged item can also be a component of such an item or group of items (see paragraphs 128 and AG256–AG274).

123. **The hedged item must be reliably measurable.**

124. **If a hedged item is a forecast transaction (or a component thereof), that transaction must be highly probable.**

125. **An aggregated exposure that is a combination of an exposure that could qualify as a hedged item in accordance with paragraph 122 and a derivative may be designated as a hedged item (see paragraphs AG252–AG253). This includes a forecast transaction of an aggregated exposure (i.e., uncommitted but anticipated future transactions that would give rise to an exposure and a derivative) if that aggregated exposure is highly probable and, once it has occurred and is therefore no longer forecast, is eligible as a hedged item.**

126. **For hedge accounting purposes, only assets, liabilities, firm commitments or highly probable forecast transactions with a party external to the reporting entity can be designated as hedged items. Hedge accounting can be applied to transactions between entities in the same economic entity only in the individual or separate financial statements of those entities and not in the consolidated financial statements of the economic entity, except for:**

(a) **The consolidated financial statements of an investment entity, as defined in PBE IPSAS 35, where transactions between an investment entity and its controlled entities measured at fair value through surplus or deficit will not be eliminated in the consolidated financial statements; or**

(b) **The consolidated financial statements of a controlling entity of an investment entity, as defined in PBE IPSAS 35, that is not itself an investment entity, where transactions between a controlled investment entity and the investments of a controlled investment entity measured at fair value through surplus or deficit will not be eliminated in the consolidated financial statements.**

127. However, as an exception to paragraph 126, the foreign currency risk of a monetary item within an economic entity (for example, a payable/receivable between two controlled entities) may qualify as a hedged item in the consolidated financial statements if it results in an exposure to foreign exchange rate gains or losses that are not fully eliminated on consolidation in accordance with PBE IPSAS 4 *The Effects of Changes in Foreign Exchange Rates*. In accordance with PBE IPSAS 4, foreign exchange rate gains and losses on monetary items within an economic entity are not fully eliminated on consolidation when the monetary item is transacted between two entities within the economic entity that have different functional currencies. In addition, the foreign currency risk of a highly probable forecast transaction within the economic entity may qualify as a hedged item in consolidated financial statements provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated surplus or deficit.

Designation of Hedged Items

128. An entity may designate an item in its entirety or a component of an item as the hedged item in a hedging relationship. An entire item comprises all changes in the cash flows or fair value of an item. A component comprises less than the entire fair value change or cash flow variability of an item. In that case, an entity may designate only the following types of components (including combinations) as hedged items:

(a) Only changes in the cash flows or fair value of an item attributable to a specific risk or risks (risk component), provided that, based on an assessment within the context of the particular market structure, the risk component is separately identifiable and reliably measurable (see paragraphs AG257–AG264). Risk components include a designation of only changes in the cash flows or the fair value of a hedged item above or below a specified price or other variable (a one-sided risk).

(b) One or more selected contractual cash flows.

(c) Components of a nominal amount, i.e., a specified part of the amount of an item (see paragraphs AG265–AG269).

Qualifying Criteria for Hedge Accounting

129. **A hedging relationship qualifies for hedge accounting only if all of the following criteria are met:**

(a) **The hedging relationship consists only of eligible hedging instruments and eligible hedged items.**

(b) **At the inception of the hedging relationship there is formal designation and documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge. That documentation shall include identification of the hedging instrument, the hedged item, the nature of the risk being hedged and how the entity will assess whether the hedging relationship meets the hedge effectiveness requirements (including its analysis of the sources of hedge ineffectiveness and how it determines the hedge ratio).**

(c) **The hedging relationship meets all of the following hedge effectiveness requirements:**

(i) **There is an economic relationship between the hedged item and the hedging instrument (see paragraphs AG278–AG280);**

(ii) **The effect of credit risk does not dominate the value changes that result from that economic relationship (see paragraphs AG281–AG282); and**

(iii) **The hedge ratio of the hedging relationship is the same as that resulting from the quantity of the hedged item that the entity actually hedges and the quantity of the hedging instrument that the entity actually uses to hedge that quantity of hedged item. However, that designation shall not reflect an imbalance between the weightings of the hedged item and the hedging instrument that would create hedge ineffectiveness (irrespective of whether recognised or not) that could result in an accounting outcome that would be inconsistent with the purpose of hedge accounting (see paragraphs AG283–AG285).**

Accounting for Qualifying Hedging Relationships

130. **An entity applies hedge accounting to hedging relationships that meet the qualifying criteria in paragraph 129 (which include the entity's decision to designate the hedging relationship).**

131. **There are three types of hedging relationships:**

(a) **Fair value hedge: a hedge of the exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, or a component of any such item, that is attributable to a particular risk and could affect surplus or deficit.**

(b) **Cash flow hedge: a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with all, or a component of, a recognised asset or liability (such as all or some future interest payments on variable-rate debt) or a highly probable forecast transaction, and could affect surplus or deficit.**

(c) **Hedge of a net investment in a foreign operation as defined in PBE IPSAS 4.**

132. If the hedged item is an equity instrument for which an entity has elected to present changes in fair value in other comprehensive revenue and expense in accordance with paragraph 106, the hedged exposure referred to in paragraph 131(a) must be one that could affect other comprehensive revenue and expense. In that case, and only in that case, the recognised hedge ineffectiveness is presented in other comprehensive revenue and expense.

133. A hedge of the foreign currency risk of a firm commitment may be accounted for as a fair value hedge or a cash flow hedge.

134. **If a hedging relationship ceases to meet the hedge effectiveness requirement relating to the hedge ratio (see paragraph 129(c)(iii)) but the risk management objective for that designated hedging relationship remains the same, an entity shall adjust the hedge ratio of the hedging relationship so that it meets the qualifying criteria again (this is referred to in this Standard as 'rebalancing'—see paragraphs AG300–AG314).**

135. **An entity shall discontinue hedge accounting prospectively only when the hedging relationship (or a part of a hedging relationship) ceases to meet the qualifying criteria (after taking into account any rebalancing of the hedging relationship, if applicable). This includes instances when the hedging instrument expires or is sold, terminated or exercised. For this purpose, the replacement or rollover of a hedging instrument into another hedging instrument is not an expiration or termination if such a replacement or rollover is part of, and consistent with, the entity's documented risk management objective. Additionally, for this purpose there is not an expiration or termination of the hedging instrument if:**

(a) **As a consequence of laws or regulations or the introduction of laws or regulations, the parties to the hedging instrument agree that one or more clearing counterparties replace their original counterparty to become the new counterparty to each of the parties. For this purpose, a clearing counterparty is a central counterparty (sometimes called a 'clearing organisation' or 'clearing agency') or an entity or entities, for example, a clearing member of a clearing organisation or a client of a clearing member of a clearing organisation, that are acting as a counterparty in order to effect clearing by a central counterparty. However, when the parties to the hedging instrument replace their original counterparties with different counterparties the requirement in this subparagraph is met only if each of those parties effects clearing with the same central counterparty.**

(b) **Other changes, if any, to the hedging instrument are limited to those that are necessary to effect such a replacement of the counterparty. Such changes are limited to those that are consistent with the terms that would be expected if the hedging instrument were originally cleared with the clearing counterparty. These changes include changes in the collateral requirements, rights to offset receivables and payables balances, and charges levied.**

Discontinuing hedge accounting can either affect a hedging relationship in its entirety or only a part of it (in which case hedge accounting continues for the remainder of the hedging relationship).

136. An entity shall apply:

(a) Paragraph 139 when it discontinues hedge accounting for a fair value hedge for which the hedged item is (or is a component of) a financial instrument measured at amortised cost; and

(b) Paragraph 141 when it discontinues hedge accounting for cash flow hedges.

Fair Value Hedges

137. **As long as a fair value hedge meets the qualifying criteria in paragraph 129, the hedging relationship shall be accounted for as follows:**

(a) **The gain or loss on the hedging instrument shall be recognised in surplus or deficit (or other comprehensive revenue and expense, if the hedging instrument hedges an equity instrument for which an entity has elected to present changes in fair value in other comprehensive revenue and expense in accordance with paragraph 106).**

(b) **The hedging gain or loss on the hedged item shall adjust the carrying amount of the hedged item (if applicable) and be recognised in surplus or deficit. If the hedged item is a financial asset (or a component thereof) that is measured at fair value through other comprehensive revenue and expense in accordance with paragraph 41, the hedging gain or loss on the hedged item shall be recognised in surplus or deficit. However, if the hedged item is an equity instrument for which an entity has elected to present changes in fair value in other comprehensive revenue and expense in accordance with paragraph 106, those amounts shall remain in other comprehensive revenue and expense. When a hedged item is an unrecognised firm commitment (or a component thereof), the cumulative change in the fair value of the hedged item subsequent to its designation is recognised as an asset or a liability with a corresponding gain or loss recognised in surplus or deficit.**

138. When a hedged item in a fair value hedge is a firm commitment (or a component thereof) to acquire an asset or assume a liability, the initial carrying amount of the asset or the liability that results from the entity meeting the firm commitment is adjusted to include the cumulative change in the fair value of the hedged item that was recognised in the statement of financial position.

139. Any adjustment arising from paragraph 137(b) shall be amortised to surplus or deficit if the hedged item is a financial instrument (or a component thereof) measured at amortised cost. Amortisation may begin as soon as an adjustment exists and shall begin no later than when the hedged item ceases to be adjusted for hedging gains and losses. The amortisation is based on a recalculated effective interest rate at the date that amortisation begins. In the case of a financial asset (or a component thereof) that is a hedged item and that is measured at fair value through other comprehensive revenue and expense in accordance with paragraph 41, amortisation applies in the same manner but to the amount that represents the cumulative gain or loss previously recognised in accordance with paragraph 137(b) instead of by adjusting the carrying amount.

Cash Flow Hedges

140. **As long as a cash flow hedge meets the qualifying criteria in paragraph 129, the hedging relationship shall be accounted for as follows:**

(a) **The separate component of net assets/equity associated with the hedged item (cash flow hedge reserve) is adjusted to the lower of the following (in absolute amounts):**

(i) **The cumulative gain or loss on the hedging instrument from inception of the hedge; and**

(ii) **The cumulative change in fair value (present value) of the hedged item (i.e., the present value of the cumulative change in the hedged expected future cash flows) from inception of the hedge.**

(b) **The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge (i.e., the portion that is offset by the change in the cash flow hedge reserve calculated in accordance with (a)) shall be recognised in other comprehensive revenue and expense.**

(c) **Any remaining gain or loss on the hedging instrument (or any gain or loss required to balance the change in the cash flow hedge reserve calculated in accordance with (a)) is hedge ineffectiveness that shall be recognised in surplus or deficit.**

(d) **The amount that has been accumulated in the cash flow hedge reserve in accordance with (a) shall be accounted for as follows:**

(i) **If a hedged forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, or a hedged forecast transaction for a non-financial asset or a non-financial liability becomes a firm commitment for which fair value hedge accounting is applied, the entity shall remove that amount from the cash flow hedge reserve and include it directly in the initial cost or other carrying amount of the asset or the liability. This is not a reclassification adjustment (see PBE IPSAS 1) and hence it does not affect other comprehensive revenue and expense.**

(ii) **For cash flow hedges other than those covered by (i), that amount shall be reclassified from the cash flow hedge reserve to surplus or deficit as a reclassification adjustment (see PBE IPSAS 1) in the same period or periods during which the hedged expected**

future cash flows affect surplus or deficit (for example, in the periods that interest revenue or interest expense is recognised or when a forecast sale occurs).

(iii) **However, if that amount is a loss and an entity expects that all or a portion of that loss will not be recovered in one or more future periods, it shall immediately reclassify the amount that is not expected to be recovered into surplus or deficit as a reclassification adjustment (see PBE IPSAS 1).**

141. When an entity discontinues hedge accounting for a cash flow hedge (see paragraphs 135 and 136(b)) it shall account for the amount that has been accumulated in the cash flow hedge reserve in accordance with paragraph 140(a) as follows:

(a) If the hedged future cash flows are still expected to occur, that amount shall remain in the cash flow hedge reserve until the future cash flows occur or until paragraph 140(d)(iii) applies. When the future cash flows occur, paragraph 140(d) applies.

(b) If the hedged future cash flows are no longer expected to occur, that amount shall be immediately reclassified from the cash flow hedge reserve to surplus or deficit as a reclassification adjustment (see PBE IPSAS 1). A hedged future cash flow that is no longer highly probable to occur may still be expected to occur.

Hedges of a Net Investment in a Foreign Operation

142. **Hedges of a net investment in a foreign operation, including a hedge of a monetary item that is accounted for as part of the net investment (see PBE IPSAS 4), shall be accounted for similarly to cash flow hedges:**

(a) **The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge shall be recognised in other comprehensive revenue and expense (see paragraph 140); and**

(b) **The ineffective portion shall be recognised in surplus or deficit.**

143. **The cumulative gain or loss on the hedging instrument relating to the effective portion of the hedge that has been accumulated in the foreign currency translation reserve shall be reclassified from net assets/equity to surplus or deficit as a reclassification adjustment (see PBE IPSAS 1) in accordance with paragraphs 57–58 of PBE IPSAS 4 on the disposal or partial disposal of the foreign operation.**

Accounting for the Time Value of Options

144. When an entity separates the intrinsic value and time value of an option contract and designates as the hedging instrument only the change in intrinsic value of the option (see paragraph 119(a)), it shall account for the time value of the option as follows (see paragraphs AG322–AG326):

(a) An entity shall distinguish the time value of options by the type of hedged item that the option hedges (see paragraph AG322):

(i) A transaction related hedged item; or

(ii) A time-period related hedged item.

(b) The change in fair value of the time value of an option that hedges a transaction related hedged item shall be recognised in other comprehensive revenue and expense to the extent that it relates to the hedged item and shall be accumulated in a separate component of net assets/equity. The cumulative change in fair value arising from the time value of the option that has been accumulated in a separate component of net assets/equity (the 'amount') shall be accounted for as follows:

(i) If the hedged item subsequently results in the recognition of a non-financial asset or a non-financial liability, or a firm commitment for a non-financial asset or a non-financial liability for which fair value hedge accounting is applied, the entity shall remove the amount from the separate component of net assets/equity and include it directly in the initial cost or other carrying amount of the asset or the liability. This is not a reclassification adjustment (see PBE IPSAS 1) and hence does not affect other comprehensive revenue and expense.

(ii) For hedging relationships other than those covered by (i), the amount shall be reclassified from the separate component of net assets/equity to surplus or deficit as a reclassification adjustment (see PBE IPSAS 1) in the same period or periods during which the hedged expected future cash flows affect surplus or deficit (for example, when a forecast sale occurs).

(iii) However, if all or a portion of that amount is not expected to be recovered in one or more future periods, the amount that is not expected to be recovered shall be immediately reclassified into surplus or deficit as a reclassification adjustment (see PBE IPSAS 1).

(c) The change in fair value of the time value of an option that hedges a time-period related hedged item shall be recognised in other comprehensive revenue and expense to the extent that it relates to the hedged item and shall be accumulated in a separate component of net assets/equity. The time value at the date of designation of the option as a hedging instrument, to the extent that it relates to the hedged item, shall be amortised on a systematic and rational basis over the period during which the hedge adjustment for the option's intrinsic value could affect surplus or deficit (or other comprehensive revenue and expense, if the hedged item is an equity instrument for which an entity has elected to present changes in fair value in other comprehensive revenue and expense in accordance with paragraph 106). Hence, in each reporting period, the amortisation amount shall be reclassified from the separate component of net assets/equity to surplus or deficit as a reclassification adjustment (see PBE IPSAS 1). However, if hedge accounting is discontinued for the hedging relationship that includes the change in intrinsic value of the option as the hedging instrument, the net amount (i.e., including cumulative amortisation) that has been accumulated in the separate component of net assets/equity shall be immediately reclassified into surplus or deficit as a reclassification adjustment (see PBE IPSAS 1).

Accounting for the Forward Element of Forward Contracts and Foreign Currency Basis Spreads of Financial Instruments

145. When an entity separates the forward element and the spot element of a forward contract and designates as the hedging instrument only the change in the value of the spot element of the forward contract, or when an entity separates the foreign currency basis spread from a financial instrument and excludes it from the designation of that financial instrument as the hedging instrument (see paragraph 119(b)), the entity may apply paragraph 144 to the forward element of the forward contract or to the foreign currency basis spread in the same manner as it is applied to the time value of an option. In that case, the entity shall apply the application guidance in paragraphs AG327–AG332.

Hedges of a Group of Items

Eligibility of a Group of Items as the Hedged Item

146. **A group of items (including a group of items that constitute a net position; see paragraphs AG333–AG340) is an eligible hedged item only if:**

(a) **It consists of items (including components of items) that are, individually, eligible hedged items;**

(b) **The items in the group are managed together on a group basis for risk management purposes; and**

(c) **In the case of a cash flow hedge of a group of items whose variabilities in cash flows are not expected to be approximately proportional to the overall variability in cash flows of the group so that offsetting risk positions arise:**

(i) **It is a hedge of foreign currency risk; and**

(ii) **The designation of that net position specifies the reporting period in which the forecast transactions are expected to affect surplus or deficit, as well as their nature and volume (see paragraphs AG339–AG340).**

Designation of a Component of a Nominal Amount

147. A component that is a proportion of an eligible group of items is an eligible hedged item provided that designation is consistent with the entity's risk management objective.

148. A layer component of an overall group of items (for example, a bottom layer) is eligible for hedge accounting only if:

(a) It is separately identifiable and reliably measurable;

(b) The risk management objective is to hedge a layer component;

(c) The items in the overall group from which the layer is identified are exposed to the same hedged risk (so that the measurement of the hedged layer is not significantly affected by which particular items from the overall group form part of the hedged layer);

(d) For a hedge of existing items (for example, an unrecognised firm commitment or a recognised asset) an entity can identify and track the overall group of items from which the hedged layer is defined (so that the entity is able to comply with the requirements for the accounting for qualifying hedging relationships); and

(e) Any items in the group that contain prepayment options meet the requirements for components of a nominal amount (see paragraph AG269).

Presentation

149. For a hedge of a group of items with offsetting risk positions (i.e., in a hedge of a net position) whose hedged risk affects different line items in the statement of comprehensive revenue and expense, any hedging gains or losses in that statement shall be presented in a separate line from those affected by the hedged items. Hence, in that statement the amount in the line item that relates to the hedged item itself (for example, revenue or expenses) remains unaffected.

150. For assets and liabilities that are hedged together as a group in a fair value hedge, the gain or loss in the statement of financial position on the individual assets and liabilities shall be recognised as an adjustment of the carrying amount of the respective individual items comprising the group in accordance with paragraph 137(b).

Nil Net Positions

151. When the hedged item is a group that is a nil net position (i.e., the hedged items among themselves fully offset the risk that is managed on a group basis), an entity is permitted to designate it in a hedging relationship that does not include a hedging instrument, provided that:

(a) The hedge is part of a rolling net risk hedging strategy, whereby the entity routinely hedges new positions of the same type as time moves on (for example, when transactions move into the time horizon for which the entity hedges);

(b) The hedged net position changes in size over the life of the rolling net risk hedging strategy and the entity uses eligible hedging instruments to hedge the net risk (i.e., when the net position is not nil);

(c) Hedge accounting is normally applied to such net positions when the net position is not nil and it is hedged with eligible hedging instruments; and

(d) Not applying hedge accounting to the nil net position would give rise to inconsistent accounting outcomes, because the accounting would not recognise the offsetting risk positions that would otherwise be recognised in a hedge of a net position.

Option to Designate a Credit Exposure as Measured at Fair Value Through Surplus or Deficit

Eligibility of Credit Exposures for Designation at Fair Value Through Surplus or Deficit

152. **If an entity uses a credit derivative that is measured at fair value through surplus or deficit to manage the credit risk of all, or a part of, a financial instrument (credit exposure) it may designate that financial instrument to the extent that it is so managed (i.e., all or a proportion of it) as measured at fair value through surplus or deficit if:**

(a) **The name of the credit exposure (for example, the borrower, or the holder of a loan commitment) matches the reference entity of the credit derivative ('name matching'); and**

(b) **The seniority of the financial instrument matches that of the instruments that can be delivered in accordance with the credit derivative.**

An entity may make this designation irrespective of whether the financial instrument that is managed for credit risk is within the scope of this Standard (for example, an entity may designate loan commitments that are outside the scope of this Standard). The entity may designate that financial instrument at, or subsequent to, initial recognition, or while it is unrecognised. The entity shall document the designation concurrently.

Accounting for Credit Exposures Designated at Fair Value Through Surplus or Deficit

153. If a financial instrument is designated in accordance with paragraph 152 as measured at fair value through surplus or deficit after its initial recognition, or was previously not recognised, the difference at the time of designation between the carrying amount, if any, and the fair value shall immediately be recognised in surplus or deficit. For financial assets measured at fair value through other comprehensive revenue and expense in accordance with paragraph 41, the cumulative gain or loss previously recognised in other comprehensive revenue and expense shall immediately be reclassified from net assets/equity to surplus or deficit as a reclassification adjustment (see PBE IPSAS 1).

154. An entity shall discontinue measuring the financial instrument that gave rise to the credit risk, or a proportion of that financial instrument, at fair value through surplus or deficit if:

(a) The qualifying criteria in paragraph 152 are no longer met, for example:

(i) The credit derivative or the related financial instrument that gives rise to the credit risk expires or is sold, terminated or settled; or

(ii) The credit risk of the financial instrument is no longer managed using credit derivatives. For example, this could occur because of improvements in the credit quality of the borrower or the loan commitment holder or changes to capital requirements imposed on an entity; and

(b) The financial instrument that gives rise to the credit risk is not otherwise required to be measured at fair value through surplus or deficit (i.e., the entity's management model has not changed in the meantime so that a reclassification in accordance with paragraph 54 was required).

155. When an entity discontinues measuring the financial instrument that gives rise to the credit risk, or a proportion of that financial instrument, at fair value through surplus or deficit, that financial instrument's fair value at the date of discontinuation becomes its new carrying amount. Subsequently, the same measurement that was used before designating the financial instrument at fair value through surplus or deficit shall be applied (including amortisation that results from the new carrying amount). For example, a financial asset that had originally been classified as measured at amortised cost would revert to that measurement and its effective interest rate would be recalculated based on its new gross carrying amount on the date of discontinuing measurement at fair value through surplus or deficit.

Effective Date and Transition

Effective Date

156. An entity shall apply this Standard for annual periods beginning on or after 1 January 2022. Earlier application is permitted. If an entity elects to apply this Standard early, it must disclose that fact and apply all of the requirements in this Standard at the same time (but see also paragraphs 173 and 179). It shall also, at the same time, apply the amendments in Appendix D.

157. [Not used.]

Transition

157.1. An entity that has previously applied PBE IFRS 9 *Financial Instruments* shall apply the transition provisions in paragraphs 157.3–157.11. An entity that has not previously applied PBE IFRS 9 shall apply the transition provisions in paragraphs 158–184.

157.2 For the purposes of the transition provisions, the date of initial application is the date when an entity first applies the requirements of this Standard and must be the beginning of a reporting period after the issue of this Standard.

Entities Transitioning from PBE IFRS 9

157.3 When an entity that has previously applied PBE IFRS 9 first applies this Standard, it shall not change the classification or measurement of its existing financial assets and financial liabilities on the date of initial application, except as expressly permitted or required by this Standard or other PBE Standards. In such cases an entity shall also apply any other transition requirements in this Standard that are necessary.

Prepayment Features with Negative Compensation

157.4 When an entity that has previously applied PBE IFRS 9 first applies this Standard, on the date of initial application, with regard to designating a financial asset or financial liability as measured at fair value through surplus or deficit, an entity applies the requirements in paragraphs AG73–AG74.1 of this Standard (referred to as the revised requirements). An entity:

(a) Shall revoke its previous designation of a financial asset as measured at fair value through surplus or deficit if that designation was previously made in accordance with the condition in paragraph 44 but that condition is no longer satisfied as a result of the application of the revised requirements;

(b) May designate a financial asset as measured at fair value through surplus or deficit if that designation would not have previously satisfied the condition in paragraph 44 but that condition is now satisfied as a result of the application of the revised requirements;

(c) Shall revoke its previous designation of a financial liability as measured at fair value through surplus or deficit if that designation was previously made in accordance with the condition in paragraph 46(a) but that condition is no longer satisfied as a result of the application of the revised requirements; and

(d) May designate a financial liability as measured at fair value through surplus or deficit if that designation would not have previously satisfied the condition in paragraph 46(a) but that condition is now satisfied as a result of the application of the revised requirements.

Such a designation and revocation shall be made on the basis of the facts and circumstances that exist at the date of initial application of this Standard. That classification shall be applied retrospectively.

157.5 An entity is not required to restate prior periods to reflect the application of the revised requirements. The entity may restate prior periods if, and only if, it is possible without the use of hindsight and the restated financial statements reflect all the requirements in this Standard. If an entity does not restate prior periods, the entity shall recognise any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the date of initial application of the revised requirements in the opening accumulated comprehensive revenue and expense (or other component of net assets/equity, as appropriate) of the annual reporting period that includes the date of initial application of the revised requirements in this Standard.

157.6 In the reporting period that includes the date of initial application of the revised requirements, the entity shall disclose the following information as at that date of initial application for each class of financial assets and financial liabilities that were affected by the revised requirements:

(a) The previous measurement category and carrying amount determined immediately before applying the revised requirements;

(b) The new measurement category and carrying amount determined after applying the revised requirements;

(c) The carrying amount of any financial assets and financial liabilities in the statement of financial position that were previously designated as measured at fair value through surplus or deficit but are no longer so designated; and

(d) The reasons for any designation or de-designation of financial assets or financial liabilities as measured at fair value through surplus or deficit.

Hedge Accounting

157.7 When an entity that has previously applied the hedge accounting requirements of PBE IFRS 9 first applies this Standard it shall apply the requirements in paragraphs 113–155 of this Standard. On first time application of this Standard it shall apply hedge accounting to the existing hedging relationships to which it applied hedge accounting under PBE IFRS 9.

157.8 When an entity that has previously applied PBE IFRS 9 continued to apply the hedge accounting requirements of PBE IPSAS 29 it may continue to apply those requirements. Alternatively, an entity may elect, on adoption of this Standard, to apply the requirements in paragraphs 113–155 of this Standard in accordance with paragraphs 179–184 of this Standard.

Simplified Approach for Receivables – Impairment

157.9 When an entity that has previously applied PBE IFRS 9 first applies this Standard, on the date of initial application, with respect to the simplified approach for receivables, an entity applies the requirements in paragraph 87 retrospectively from the beginning of the earliest comparative period presented. However, the entity is not required to restate prior periods to reflect the application of paragraph 87. If an entity does not restate prior periods, the entity shall recognise any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the date of initial application of paragraph 87 in the opening accumulated comprehensive revenue and expense (or other component of net assets/equity, as appropriate) of the annual reporting period that includes the date of initial application of paragraph 87.

Offsetting Financial Assets and Financial Liabilities

157.10 When an entity that has previously applied PBE IFRS 9 first applies this Standard it shall apply the requirements in paragraphs AG63A–AG63F of PBE IPSAS 28 (which include requirements related to offsetting financial assets and financial liabilities) retrospectively from the beginning of the earliest comparative period presented. Restatement is required. In addition, the entity shall provide the disclosures required by paragraphs 17A–17F and paragraphs AG42–AG55 of PBE IPSAS 30 in accordance with the transitional provisions in paragraph 53.7 of PBE IPSAS 30.

Extinguishing Financial Liabilities with Equity Instruments

157.11 When an entity that has previously applied PBE IFRS 9 first applies this Standard, on the date of initial application, an entity applies the requirements in Appendix C of this Standard with regard to extinguishing financial liabilities with equity instruments. An entity applies the requirements of Appendix C retrospectively from the beginning of the earliest comparative period presented. However, the entity is not required to restate prior periods to reflect the application of Appendix C. If an entity does not restate prior periods, the entity shall recognise any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the date of initial application of Appendix C in the opening accumulated comprehensive revenue and expense (or other component of net assets/equity, as appropriate) of the annual reporting period that includes the date of initial application of Appendix C.

Entities Transitioning from PBE IPSAS 29

158. An entity shall apply this Standard retrospectively, in accordance with PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors,* except as specified in paragraphs 161–184. This Standard shall not be applied to items that have already been derecognised at the date of initial application.

159. [Not used]

Transition for Classification and Measurement

160. At the date of initial application, an entity shall assess whether a financial asset meets the condition in paragraphs 40(a) or 41(a) on the basis of the facts and circumstances that exist at that date. The resulting classification shall be applied retrospectively irrespective of the entity's management model in prior reporting periods.

161. If, at the date of initial application, it is impracticable (as defined in PBE IPSAS 3) for an entity to assess a modified time value of money element in accordance with paragraphs AG68–AG70 on the basis of the facts and circumstances that existed at the initial recognition of the financial asset, an entity shall assess the contractual cash flow characteristics of that financial asset on the basis of the facts and circumstances that existed at the initial recognition of the financial asset without taking into account the requirements related to the modification of the time value of money element in paragraphs AG68–AG70. (See also paragraph 49R of PBE IPSAS 30.)

162. If, at the date of initial application, it is impracticable (as defined in PBE IPSAS 3) for an entity to assess whether the fair value of a prepayment feature was insignificant in accordance with paragraph AG74(c) on

the basis of the facts and circumstances that existed at the initial recognition of the financial asset, an entity shall assess the contractual cash flow characteristics of that financial asset on the basis of the facts and circumstances that existed at the initial recognition of the financial asset without taking into account the exception for prepayment features in paragraph AG74. (See also paragraph 49S of PBE IPSAS 30.)

163. If an entity measures a hybrid contract at fair value in accordance with paragraphs 41, 43 or 44 but the fair value of the hybrid contract had not been measured in comparative reporting periods, the fair value of the hybrid contract in the comparative reporting periods shall be the sum of the fair values of the components (i.e., the non-derivative host and the embedded derivative) at the end of each comparative reporting period if the entity restates prior periods (see paragraph 173).

164. If an entity has applied paragraph 163 then at the date of initial application the entity shall recognise any difference between the fair value of the entire hybrid contract at the date of initial application and the sum of the fair values of the components of the hybrid contract at the date of initial application in the opening accumulated comprehensive revenue and expense (or other component of net assets/equity, as appropriate) of the reporting period that includes the date of initial application.

165. At the date of initial application an entity may designate:

(a) A financial asset as measured at fair value through surplus or deficit in accordance with paragraph 44; or

(b) An investment in an equity instrument as at fair value through other comprehensive revenue and expense in accordance with paragraph 106.

Such a designation shall be made on the basis of the facts and circumstances that exist at the date of initial application. That classification shall be applied retrospectively.

166. At the date of initial application an entity:

(a) Shall revoke its previous designation of a financial asset as measured at fair value through surplus or deficit if that financial asset does not meet the condition in paragraph 44.

(b) May revoke its previous designation of a financial asset as measured at fair value through surplus or deficit if that financial asset meets the condition in paragraph 44.

Such a revocation shall be made on the basis of the facts and circumstances that exist at the date of initial application. That classification shall be applied retrospectively.

167. At the date of initial application, an entity:

(a) May designate a financial liability as measured at fair value through surplus or deficit in accordance with paragraph 46(a).

(b) Shall revoke its previous designation of a financial liability as measured at fair value through surplus or deficit if such designation was made at initial recognition in accordance with the condition now in paragraph 46(a) and such designation does not satisfy that condition at the date of initial application.

(c) May revoke its previous designation of a financial liability as measured at fair value through surplus or deficit if such designation was made at initial recognition in accordance with the condition now in paragraph 46(a) and such designation satisfies that condition at the date of initial application.

Such a designation and revocation shall be made on the basis of the facts and circumstances that exist at the date of initial application. That classification shall be applied retrospectively.

168. If it is impracticable (as defined in PBE IPSAS 3) for an entity to apply retrospectively the effective interest method, the entity shall treat:

(a) The fair value of the financial asset or the financial liability at the end of each comparative period presented as the gross carrying amount of that financial asset or the amortised cost of that financial liability if the entity restates prior periods; and

(b) The fair value of the financial asset or the financial liability at the date of initial application as the new gross carrying amount of that financial asset or the new amortised cost of that financial liability at the date of initial application of this Standard.

169. If an entity previously accounted at cost (in accordance with PBE IPSAS 29), for an investment in an equity instrument that does not have a quoted price in an active market for an identical instrument (i.e., a Level 1 input) (or for a derivative asset that is linked to and must be settled by delivery of such an equity instrument) it shall measure that instrument at fair value at the date of initial application. Any difference between the previous carrying amount and the fair value shall be recognised in the opening accumulated comprehensive revenue and expense (or other component of net assets/equity, as appropriate) of the reporting period that includes the date of initial application.

169.1 Despite the requirements in paragraphs 45(c)(ii) and AG136, an entity that was previously unable to determine a reliable measure of the fair value of a financial guarantee contract issued through a non-exchange transaction shall, at the date of initial application, measure the contract at the higher of:

(a) the loss allowance determined in accordance with paragraphs 73–93; and

(b) the previous carrying amount determined in accordance with PBE IPSAS 29.

Any difference between the amount determined at the date of initial application and the previous carrying amount shall be recognised in the opening accumulated comprehensive revenue and expense of the reporting period that includes the date of initial application. The amount recognised at the date of initial application becomes the amount initially recognised in accordance with this Standard.

170. If an entity previously accounted for a derivative liability that is linked to, and must be settled by, delivery of an equity instrument that does not have a quoted price in an active market for an identical instrument (i.e., a Level 1 input) at cost in accordance with PBE IPSAS 29, it shall measure that derivative liability at fair value at the date of initial application. Any difference between the previous carrying amount and the fair value shall be recognised in the opening accumulated comprehensive revenue and expense of the reporting period that includes the date of initial application.

171. At the date of initial application, an entity shall determine whether the treatment in paragraph 108 would create or enlarge an accounting mismatch in surplus or deficit on the basis of the facts and circumstances that exist at the date of initial application. This Standard shall be applied retrospectively on the basis of that determination.

172. At the date of initial application, an entity is permitted to make the designation in paragraph 6 for contracts that already exist on the date but only if it designates all similar contracts. The change in the net assets resulting from such designations shall be recognised in net assets/equity at the date of initial application.

173. Despite the requirement in paragraph 158, an entity that adopts the classification and measurement requirements of this Standard (which include the requirements related to amortised cost measurement for financial assets and impairment in paragraphs 69–72 and paragraphs 73–93) shall provide the disclosures set out in paragraphs 49L–49O of PBE IPSAS 30 but need not restate prior periods. The entity may restate prior periods if, and only if, it is possible without the use of hindsight. If an entity does not restate prior periods, the entity shall recognise any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the date of initial application in the opening accumulated comprehensive revenue and expense (or other component of net assets/equity, as appropriate) of the annual reporting period that includes the date of initial application. However, if an entity restates prior periods, the restated financial statements must reflect all of the requirements in this Standard.

174. If an entity prepares interim financial reports in accordance with PBE IAS 34 *Interim Financial Reporting* the entity need not apply the requirements in this Standard to interim periods prior to the date of initial application if it is impracticable (as defined in PBE IPSAS 3).

Impairment

175. An entity shall apply the impairment requirements in paragraphs 73–93 retrospectively in accordance with PBE IPSAS 3 subject to paragraphs 173 and 176–178.

176. At the date of initial application, an entity shall use reasonable and supportable information that is available without undue cost or effort to determine the credit risk at the date that a financial instrument was initially recognised (or for loan commitments and financial guarantee contracts at the date that the entity became a party to the irrevocable commitment in accordance with paragraph 78) and compare that to the credit risk at the date of initial application of this Standard.

177. When determining whether there has been a significant increase in credit risk since initial recognition, an entity may apply:

(a) The requirements in paragraphs 82 and AG186–AG188; and

(b) The rebuttable presumption in paragraph 83 for contractual payments that are more than 30 days past due if an entity will apply the impairment requirements by identifying significant increases in credit risk since initial recognition for those financial instruments on the basis of past due information.

178. If, at the date of initial application, determining whether there has been a significant increase in credit risk since initial recognition would require undue cost or effort, an entity shall recognise a loss allowance at an amount equal to lifetime expected credit losses at each reporting date until that financial instrument is derecognised (unless that financial instrument is low credit risk at a reporting date, in which case paragraph 177(a) applies).

Transition for Hedge Accounting

179. When an entity first applies this Standard, it may choose as its accounting policy to continue to apply the hedge accounting requirements of PBE IPSAS 29 instead of the requirements in paragraphs 113–155 of this Standard. An entity shall apply that policy to all of its hedging relationships. An entity that chooses that policy shall also apply Appendix C of PBE IPSAS 29.

180. Except as provided in paragraph 184, an entity shall apply the hedge accounting requirements of this Standard prospectively.

181. To apply hedge accounting from the date of initial application of the hedge accounting requirements of this Standard, all qualifying criteria must be met as at that date.

182. Hedging relationships that qualified for hedge accounting in accordance with PBE IPSAS 29 that also qualify for hedge accounting in accordance with the criteria of this Standard (see paragraph 129), after taking into account any rebalancing of the hedging relationship on transition (see paragraph 183(b)), shall be regarded as continuing hedging relationships.

183 On initial application of the hedge accounting requirements of this Standard, an entity:

(a) May start to apply those requirements from the same point in time as it ceases to apply the hedge accounting requirements of PBE IPSAS 29; and

(b) Shall consider the hedge ratio in accordance with PBE IPSAS 29 as the starting point for rebalancing the hedge ratio of a continuing hedging relationship, if applicable. Any gain or loss from such a rebalancing shall be recognised in surplus or deficit.

184. As an exception to prospective application of the hedge accounting requirements of this Standard, an entity:

(a) Shall apply the accounting for the time value of options in accordance with paragraph 144 retrospectively if, in accordance with PBE IPSAS 29, only the change in an option’s intrinsic value was designated as a hedging instrument in a hedging relationship. This retrospective application applies only to those hedging relationships that existed at the beginning of the earliest comparative period or were designated thereafter.

(b) May apply the accounting for the forward element of forward contracts in accordance with paragraph 145 retrospectively if, in accordance with PBE IPSAS 29, only the change in the spot element of a forward contract was designated as a hedging instrument in a hedging relationship. This retrospective application applies only to those hedging relationships that existed at the beginning of the earliest comparative period or were designated thereafter. In addition, if an entity elects retrospective application of this accounting, it shall be applied to all hedging relationships that qualify for this election (i.e., on transition this election is not available on a hedging-relationship-by-hedging-relationship basis). The accounting for foreign currency basis spreads (see paragraph 145) may be applied retrospectively for those hedging relationships that existed at the beginning of the earliest comparative period or were designated thereafter.

(c) Shall apply retrospectively the requirement of paragraph 135 that there is not an expiration or termination of the hedging instrument if:

(i) As a consequence of laws or regulations, or the introduction of laws or regulations, the parties to the hedging instrument agree that one or more clearing counterparties replace their original counterparty to become the new counterparty to each of the parties; and

(ii) Other changes, if any, to the hedging instrument are limited to those that are necessary to effect such a replacement of the counterparty.

Withdrawal of PBE IFRS 9

184.1 This Standard supersedes PBE IFRS 9. *Effective Date of PBE IFRS 9,* issued in March 2019, limited the early adoption of PBE IFRS 9 to annual periods beginning before 1 January 2020.

Appendix A

Application Guidance

This Appendix is an integral part of PBE IPSAS 41.

Scope

AG1. Some contracts require a payment based on climatic, geological or other physical variables. (Those based on climatic variables are sometimes referred to as 'weather derivatives'.) If those contracts are not insurance contracts, they are within the scope of this Standard.

AG2. This Standard does not change the requirements relating to employee benefit plans that comply with the relevant international or national accounting standard on accounting and reporting by retirement benefit plans and royalty agreements based on the volume of sales or service revenues that are accounted for under PBE IPSAS 9 *Revenue from Exchange Transactions*.

AG3. Sometimes, an entity makes what it views as a 'strategic investment' in equity instruments issued by another entity, with the management model of establishing or maintaining a long-term operating relationship with the entity in which the investment is made. The investor or joint venturer entity uses PBE IPSAS 36 *Investments in Associates and Joint Ventures* to determine whether the equity method of accounting shall be applied to such an investment.

AG4. This Standard applies to the financial assets and financial liabilities of insurers, other than rights and obligations that paragraph 2(e) excludes because they arise under insurance contracts. An entity does however apply this Standard to:

(a) Financial guarantee contracts, except those where the issuer elects to treat such contracts as insurance contracts in accordance with PBE IPSAS 28 *Financial Instruments: Presentation*; and

(b) Embedded derivatives included in insurance contracts.

An entity may, but is not required to, apply this Standard to other insurance contracts that involve the transfer of financial risk.

AG5. Financial guarantee contracts may have various legal forms, such as a guarantee, some types of letter of credit, a credit default contract or an insurance contract. Their accounting treatment does not depend on their legal form. The following are examples of the appropriate treatment (see paragraph 2(e)):

(a) Although a financial guarantee contract meets the definition of an insurance contract if the risk transferred is significant, the issuer applies this Standard. Nevertheless, an entity may elect, under certain circumstances, to treat financial guarantee contracts as insurance contracts using PBE IPSAS 28 if the issuer has previously adopted an accounting policy that treated financial guarantee contracts as insurance contracts and has used accounting that is applicable to insurance contracts; the issuer may elect to apply either this Standard or PBE IFRS 4 *Insurance Contracts* to such financial guarantee contracts. If this Standard applies, paragraph 57 requires the issuer to recognise a financial guarantee contract initially at fair value. If the financial guarantee contract was issued to an unrelated party in a stand-alone arm's length transaction, its fair value at inception is likely to equal the premium received, unless there is evidence to the contrary. Subsequently, unless the financial guarantee contract was designated at inception as at fair value through surplus or deficit or unless paragraphs 26–34 and AG32–AG38 apply (when a transfer of a financial asset does not qualify for derecognition or the continuing involvement approach applies), the issuer measures it at the higher of:

(i) The amount determined in accordance with paragraphs 73–93; and

(ii) The amount initially recognised less, when appropriate, the cumulative amortisation recognised in accordance with the principles of PBE IPSAS 9 (see paragraph 45(c)).

(b) Some credit-related guarantees do not, as a precondition for payment, require that the holder is exposed to, and has incurred a loss on, the failure of the debtor to make payments on the guaranteed asset when due. An example of such a guarantee is one that requires payments in response to changes in a specified credit rating or credit index. Such guarantees are not financial guarantee contracts as defined in this Standard, and are not insurance contracts. Such guarantees are derivatives and the issuer applies this Standard to them.

(c) If a financial guarantee contract was issued in connection with the sale of goods, the issuer applies PBE IPSAS 9 in determining when it recognises the revenue from the guarantee and from the sale of goods.

AG6. Rights and obligations (assets and liabilities) may arise from non-exchange revenue transactions, for example, an entity may receive cash from a multi-lateral agency to perform certain activities. Where the performance of those activities is subject to conditions, an asset and a liability is recognised simultaneously. Where the asset is a financial asset, it is recognised in accordance with PBE IPSAS 23 *Revenue from Non-Exchange Transactions*, and initially measured in accordance with PBE IPSAS 23 and this Standard. A liability that is initially recognised as a result of conditions imposed on the use of an asset is outside the scope of this Standard and is dealt with in PBE IPSAS 23. After initial recognition, if circumstances indicate that recognition of a liability in accordance with PBE IPSAS 23 is no longer appropriate, an entity considers whether a financial liability should be recognised in accordance with this Standard. Other liabilities that may arise from non-exchange revenue transactions are recognised and measured in accordance with this Standard if they meet the definition of a financial liability in PBE IPSAS 28.

Definitions

Derivatives

AG7. Typical examples of derivatives are futures and forward, swap and option contracts. A derivative usually has a notional amount, which is an amount of currency, a number of shares, a number of units of weight or volume or other units specified in the contract. However, a derivative instrument does not require the holder or writer to invest or receive the notional amount at the inception of the contract. Alternatively, a derivative could require a fixed payment or payment of an amount that can change (but not proportionally with a change in the underlying) as a result of some future event that is unrelated to a notional amount. For example, a contract may require a fixed payment of CU1,000 if the six-month interbank offered rate increases by 100 basis points. Such a contract is a derivative even though a notional amount is not specified.

AG8. The definition of a derivative in this Standard includes contracts that are settled gross by delivery of the underlying item (e.g., a forward contract to purchase a fixed rate debt instrument). An entity may have a contract to buy or sell a non-financial item that can be settled net in cash or another financial instrument or by exchanging financial instruments (e.g., a contract to buy or sell a commodity at a fixed price at a future date). Such a contract is within the scope of this Standard unless it was entered into and continues to be held for the purpose of delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements. However, this Standard applies to such contracts for an entity's expected purchase, sale or usage requirements if the entity makes a designation in accordance with paragraph 6 (see paragraphs 5–8).

AG9. One of the defining characteristics of a derivative is that it has an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors. An option contract meets that definition because the premium is less than the investment that would be required to obtain the underlying financial instrument to which the option is linked. A currency swap that requires an initial exchange of different currencies of equal fair values meets the definition because it has a zero initial net investment.

AG10. A regular way purchase or sale gives rise to a fixed price commitment between trade date and settlement date that meets the definition of a derivative. However, because of the short duration of the commitment it is not recognised as a derivative financial instrument. Instead, this Standard provides for special accounting for such regular way contracts (see paragraphs 11 and AG17–20).

AG11. The definition of a derivative refers to non-financial variables that are not specific to a party to the contract. These include an index of earthquake losses in a particular region and an index of temperatures in a particular city. Non-financial variables specific to a party to the contract include the occurrence or non-occurrence of a fire that damages or destroys an asset of a party to the contract. A change in the fair value of a non-financial asset is specific to the owner if the fair value reflects not only changes in market prices for such assets (a financial variable) but also the condition of the specific non-financial asset held (a non-financial variable). For example, if a guarantee of the residual value of a specific car exposes the guarantor to the risk of changes in the car's physical condition, the change in that residual value is specific to the owner of the car.

Financial Assets and Liabilities Held for Trading

AG12. Trading generally reflects active and frequent buying and selling, and financial instruments held for trading generally are used with the objective of generating a profit from short-term fluctuations in price or dealer's margin.

AG13. Financial liabilities held for trading include:

(a) Derivative liabilities that are not accounted for as hedging instruments;

(b) Obligations to deliver financial assets borrowed by a short seller (i.e., an entity that sells financial assets it has borrowed and does not yet own);

(c) Financial liabilities that are incurred with a management model to repurchase them in the near term (e.g., a quoted debt instrument that the issuer may buy back in the near term depending on changes in its fair value); and

(d) Financial liabilities that are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking.

AG14. The fact that a liability is used to fund trading activities does not in itself make that liability one that is held for trading.

Recognition and Derecognition

Initial Recognition

AG15. As a consequence of the principle in paragraph 10, an entity recognises all of its contractual rights and obligations under derivatives in its statement of financial position as assets and liabilities, respectively, except for derivatives that prevent a transfer of financial assets from being accounted for as a sale (see paragraph AG35). If a transfer of a financial asset does not qualify for derecognition, the transferee does not recognise the transferred asset as its asset (see paragraph AG36).

AG16. The following are examples of applying the principle in paragraph 10:

(a) Unconditional receivables and payables are recognised as assets or liabilities when the entity becomes a party to the contract and, as a consequence, has a legal right to receive or a legal obligation to pay cash.

(b) Assets to be acquired and liabilities to be incurred as a result of a firm commitment to purchase or sell goods or services are generally not recognised until at least one of the parties has performed under the agreement. For example, an entity that receives a firm order does not generally recognise an asset (and the entity that places the order does not recognise a liability) at the time of the commitment but, instead, delays recognition until the ordered goods or services have been shipped, delivered or rendered. If a firm commitment to buy or sell non-financial items is within the scope of this Standard in accordance with paragraphs 5–8, its net fair value is recognised as an asset or a liability on the commitment date (see paragraph AG92(c)). In addition, if a previously unrecognised firm commitment is designated as a hedged item in a fair value hedge, any change in the net fair value attributable to the hedged risk is recognised as an asset or a liability after the inception of the hedge (see paragraphs 137(b) and 138).

(c) A forward contract that is within the scope of this Standard (see paragraph 2) is recognised as an asset or a liability on the commitment date, instead of on the date on which settlement takes place. When an entity becomes a party to a forward contract, the fair values of the right and obligation are often equal, so that the net fair value of the forward is zero. If the net fair value of the right and obligation is not zero, the contract is recognised as an asset or liability.

(d) Option contracts that are within the scope of this Standard (see paragraph 2) are recognised as assets or liabilities when the holder or writer becomes a party to the contract.

(e) Planned future transactions, no matter how likely, are not assets and liabilities because the entity has not become a party to a contract.

Regular Way Purchase or Sale of Financial Assets

AG17. A regular way purchase or sale of financial assets is recognised using either trade date accounting or settlement date accounting as described in paragraphs AG19 and AG20. An entity shall apply the same method consistently for all purchases and sales of financial assets that are classified in the same way in accordance with this Standard. For this purpose assets that are mandatorily measured at fair value through surplus or deficit form a separate classification from assets designated as measured at fair value through surplus or deficit. In addition, investments in equity instruments accounted for using the option provided in paragraph 106 form a separate classification.

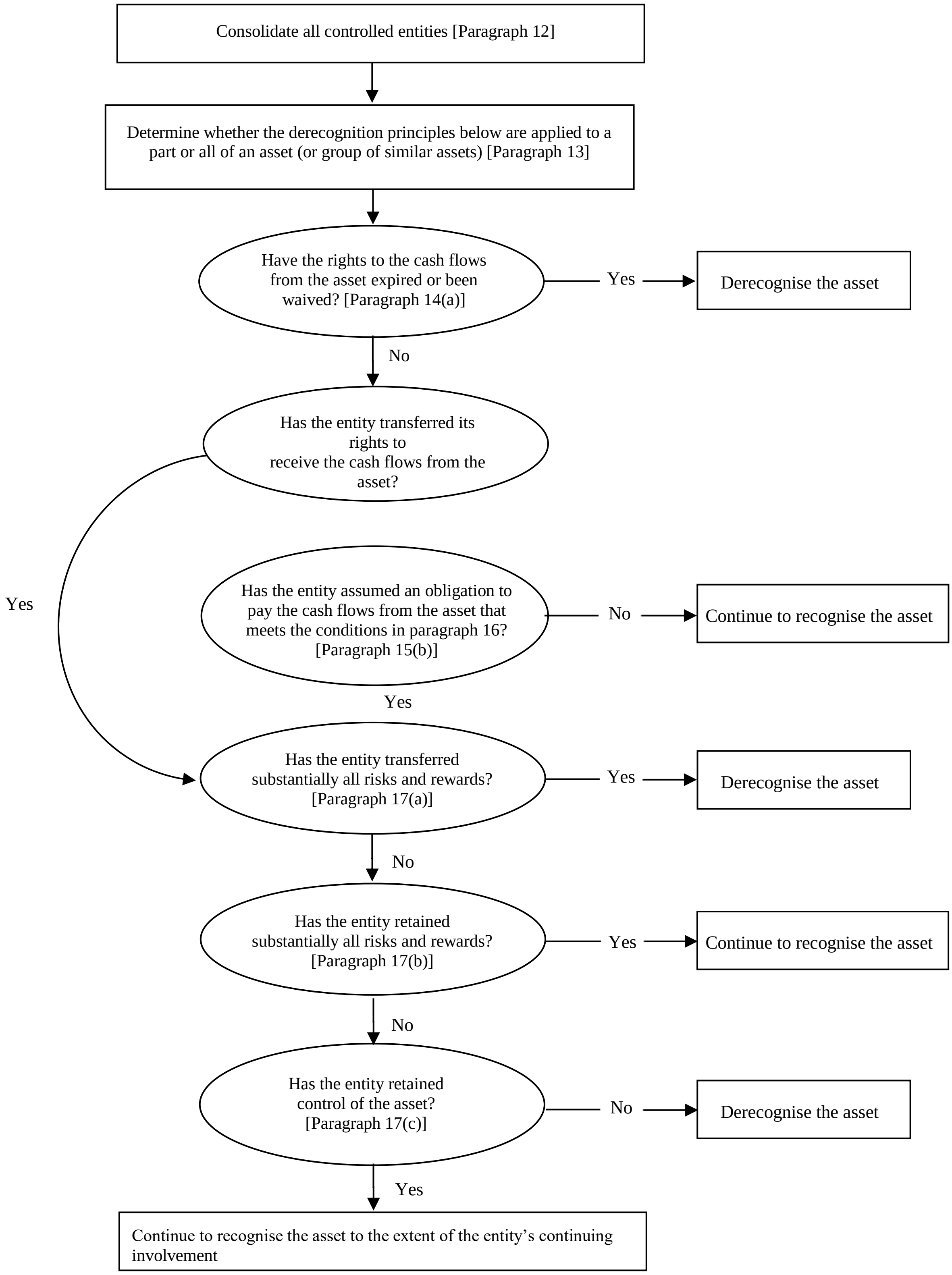
AG18. A contract that requires or permits net settlement of the change in the value of the contract is not a regular way contract. Instead, such a contract is accounted for as a derivative in the period between the trade date and the settlement date.

AG19. The trade date is the date that an entity commits itself to purchase or sell an asset. Trade date accounting refers to (a) the recognition of an asset to be received and the liability to pay for it on the trade date, and (b) derecognition of an asset that is sold, recognition of any gain or loss on disposal and the recognition of a receivable from the buyer for payment on the trade date. Generally, interest does not start to accrue on the asset and corresponding liability until the settlement date when title passes.

AG20. The settlement date is the date that an asset is delivered to or by an entity. Settlement date accounting refers to (a) the recognition of an asset on the day it is received by the entity, and (b) the derecognition of an asset and recognition of any gain or loss on disposal on the day that it is delivered by the entity. When settlement date accounting is applied an entity accounts for any change in the fair value of the asset to be received during the period between the trade date and the settlement date in the same way as it accounts for the acquired asset. In other words, the change in value is not recognised for assets measured at amortised cost; it is recognised in surplus or deficit for assets classified as financial assets measured at fair value through surplus or deficit; and it is recognised in other comprehensive revenue and expense for financial assets measured at fair value through other comprehensive revenue and expense in accordance with paragraph 41 and for investments in equity instruments accounted for in accordance with paragraph 106.

Derecognition of Financial Assets

AG21. The following flow chart illustrates the evaluation of whether and to what extent a financial asset is derecognised.



Arrangements Under Which an Entity Retains the Contractual Rights to Receive the Cash Flows of a Financial Asset, but Assumes a Contractual Obligation to Pay the Cash Flows to One or More Recipients (paragraph 15(b))

AG22. The situation described in paragraph 15(b) (when an entity retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients) occurs, for example, if the entity is a trust, and issues to investors beneficial interests in the underlying financial assets that it owns and provides servicing of those financial assets. In that case, the financial assets qualify for derecognition if the conditions in paragraphs 16 and 17 are met.

AG23. In applying paragraph 16, the entity could be, for example, the originator of the financial asset, or it could be an economic entity that includes a controlled entity that has acquired the financial asset and passes on cash flows to unrelated third party investors.

Evaluation of the Transfer of Risks and Rewards of Ownership (paragraph 17)

AG24. Examples of when an entity has transferred substantially all the risks and rewards of ownership are:

(a) An unconditional sale of a financial asset;

(b) A sale of a financial asset together with an option to repurchase the financial asset at its fair value at the time of repurchase; and

(c) A sale of a financial asset together with a put or call option that is deeply out of the money (i.e., an option that is so far out of the money it is highly unlikely to go into the money before expiry).

AG25. Examples of when an entity has retained substantially all the risks and rewards of ownership are:

(a) A sale and repurchase transaction where the repurchase price is a fixed price or the sale price plus a lender's return;

(b) A securities lending agreement;

(c) A sale of a financial asset together with a total return swap that transfers the market risk exposure back to the entity;

(d) A sale of a financial asset together with a deep in-the-money put or call option (i.e., an option that is so far in the money that it is highly unlikely to go out of the money before expiry); and

(e) A sale of short-term receivables in which the entity guarantees to compensate the transferee for credit losses that are likely to occur.

AG26. If an entity determines that as a result of the transfer, it has transferred substantially all the risks and rewards of ownership of the transferred asset, it does not recognise the transferred asset again in a future period, unless it reacquires the transferred asset in a new transaction.

Evaluation of the Transfer of Control

AG27. An entity has not retained control of a transferred asset if the transferee has the practical ability to sell the transferred asset. An entity has retained control of a transferred asset if the transferee does not have the practical ability to sell the transferred asset. A transferee has the practical ability to sell the transferred asset if it is traded in an active market because the transferee could repurchase the transferred asset in the market if it needs to return the asset to the entity. For example, a transferee may have the practical ability to sell a transferred asset if the transferred asset is subject to an option that allows the entity to repurchase it, but the transferee can readily obtain the transferred asset in the market if the option is exercised. A transferee does not have the practical ability to sell the transferred asset if the entity retains such an option and the transferee cannot readily obtain the transferred asset in the market if the entity exercises its option.

AG28. The transferee has the practical ability to sell the transferred asset only if the transferee can sell the transferred asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without imposing additional restrictions on the transfer. The critical question is what the transferee is able to do in practice, not what contractual rights the transferee has concerning what it can do with the transferred asset or what contractual prohibitions exist. In particular:

(a) A contractual right to dispose of the transferred asset has little practical effect if there is no market for the transferred asset, and

(b) An ability to dispose of the transferred asset has little practical effect if it cannot be exercised freely. For that reason:

(i) The transferee's ability to dispose of the transferred asset must be independent of the actions of others (i.e., it must be a unilateral ability), and

(ii) The transferee must be able to dispose of the transferred asset without needing to attach restrictive conditions or 'strings' to the transfer (e.g., conditions about how a loan asset is serviced or an option giving the transferee the right to repurchase the asset).

AG29. That the transferee is unlikely to sell the transferred asset does not, of itself, mean that the transferor has retained control of the transferred asset. However, if a put option or guarantee constrains the transferee from selling the transferred asset, then the transferor has retained control of the transferred asset. For example, if a put option or guarantee is sufficiently valuable it constrains the transferee from selling the transferred asset because the transferee would, in practice, not sell the transferred asset to a third party without attaching a similar option or other restrictive conditions. Instead, the transferee would hold the transferred asset so as to obtain payments under the guarantee or put option. Under these circumstances the transferor has retained control of the transferred asset.

Transfers that Qualify for Derecognition

AG30. An entity may retain the right to a part of the interest payments on transferred assets as compensation for servicing those assets. The part of the interest payments that the entity would give up upon termination or transfer of the servicing contract is allocated to the servicing asset or servicing liability. The part of the interest payments that the entity would not give up is an interest-only strip receivable. For example, if the entity would not give up any interest upon termination or transfer of the servicing contract, the entire interest spread is an interest-only strip receivable. For the purposes of applying paragraph 24, the fair values of the servicing asset and interest-only strip receivable are used to allocate the carrying amount of the receivable between the part of the asset that is derecognised and the part that continues to be recognised. If there is no servicing fee specified or the fee to be received is not expected to compensate the entity adequately for performing the servicing, a liability for the servicing obligation is recognised at fair value.

AG31. When measuring the fair values of the part that continues to be recognised and the part that is derecognised for the purposes of applying paragraph 24, an entity applies the fair value measurement requirements in paragraphs 66–68 and AG144–AG155.

Transfers that do not Qualify for Derecognition

AG32. The following is an application of the principle outlined in paragraph 26. If a guarantee provided by the entity for default losses on the transferred asset prevents a transferred asset from being derecognised because the entity has retained substantially all the risks and rewards of ownership of the transferred asset, the transferred asset continues to be recognised in its entirety and the consideration received is recognised as a liability.

Sale of Future Flows Arising from a Sovereign Right

AG33. In the public sector, securitisation schemes may involve a sale of future flows arising from a sovereign right, such as a right to taxation, that have not previously been recognised as assets. An entity recognises the revenue arising from such transactions in accordance with the relevant revenue standard (see PBE IPSAS 9 and PBE IPSAS 23). Such transactions may give rise to financial liabilities as defined in PBE IPSAS 28. Examples of such financial liabilities may include but are not limited to borrowings, financial guarantees, liabilities arising from a servicing or administrative contract, or payables relating to cash collected on behalf of the purchasing entity. Financial liabilities shall be recognised when the entity becomes party to the contractual provisions of the instrument in accordance with paragraph 10 and classified in accordance with paragraphs 45 and 46. The financial liabilities shall be initially recognised in accordance with paragraph 57, and subsequently measured in accordance with paragraphs 62 and 63.

Continuing Involvement in Transferred Assets

AG34. The following are examples of how an entity measures a transferred asset and the associated liability under paragraph 27.

All Assets

(a) If a guarantee provided by an entity to pay for default losses on a transferred asset prevents the transferred asset from being derecognised to the extent of the continuing involvement, the transferred asset at the date of the transfer is measured at the lower of (i) the carrying amount of the asset and (ii) the maximum amount of the consideration received in the transfer that the entity could be required to repay ('the guarantee amount'). The associated liability is initially measured at the guarantee amount plus the fair value of the guarantee (which is normally the consideration received for the guarantee). Subsequently, the initial fair value of the guarantee is recognised in surplus or deficit on a time proportion basis (see PBE IPSAS 9) and the carrying value of the asset is reduced by any loss allowance.

Assets Measured at Amortised Cost

(b) If a put option obligation written by an entity or call option right held by an entity prevents a transferred asset from being derecognised and the entity measures the transferred asset at amortised cost, the associated liability is measured at its cost (i.e., the consideration received) adjusted for the amortisation of any difference between that cost and the gross carrying amount of the transferred asset at the expiration date of the option. For example, assume that the gross carrying amount of the asset on the date of the transfer is CU98 and that the consideration received is CU95. The gross carrying amount of the asset on the option exercise date will be CU100. The initial carrying amount of the associated liability is CU95 and the difference between CU95 and CU100 is recognised in surplus or deficit using the effective interest method. If the option is exercised, any difference between the carrying amount of the associated liability and the exercise price is recognised in surplus or deficit.

Assets Measured at Fair Value

(c) If a call option right retained by an entity prevents a transferred asset from being derecognised and the entity measures the transferred asset at fair value, the asset continues to be measured at its fair value. The associated liability is measured at (i) the option exercise price less the time value of the option if the option is in or at the money, or (ii) the fair value of the transferred asset less the time value of the option if the option is out of the money. The adjustment to the measurement of the associated liability ensures that the net carrying amount of the asset and the associated liability is the fair value of the call option right. For example, if the fair value of the underlying asset is CU80, the option exercise price is CU95 and the time value of the option is CU5, the carrying amount of the associated liability is CU75 (CU80 – CU5) and the carrying amount of the transferred asset is CU80 (i.e., its fair value).

(d) If a put option written by an entity prevents a transferred asset from being derecognised and the entity measures the transferred asset at fair value, the associated liability is measured at the option exercise price plus the time value of the option. The measurement of the asset at fair value is limited to the lower of the fair value and the option exercise price because the entity has no right to increases in the fair value of the transferred asset above the exercise price of the option. This ensures that the net carrying amount of the asset and the associated liability is the fair value of the put option obligation. For example, if the fair value of the underlying asset is CU120, the option exercise price is CU100 and the time value of the option is CU5, the carrying amount of the associated liability is CU105 (CU100 + CU5) and the carrying amount of the asset is CU100 (in this case the option exercise price).

(e) If a collar, in the form of a purchased call and written put, prevents a transferred asset from being derecognised and the entity measures the asset at fair value, it continues to measure the asset at fair value. The associated liability is measured at (i) the sum of the call exercise price and fair value of the put option less the time value of the call option, if the call option is in or at the money, or (ii) the sum of the fair value of the asset and the fair value of the put option less the time value of the call option if the call option is out of the money. The adjustment to the associated liability ensures that the net carrying amount of the asset and the associated liability is the fair value of the options held and written by the entity. For example, assume an entity transfers a financial asset that is measured at fair value while simultaneously purchasing a call with an exercise price of CU120 and writing a put with an exercise price of CU80. Assume also that the fair value of the asset is CU100 at the date of the transfer. The time value of the put and call are CU1 and CU5 respectively. In this case, the entity recognises an asset of CU100 (the fair value of the asset) and a liability of CU96 [(CU100 + CU1) – CU5]. This gives a net asset value of CU4, which is the fair value of the options held and written by the entity.

All Transfers

AG35. To the extent that a transfer of a financial asset does not qualify for derecognition, the transferor's contractual rights or obligations related to the transfer are not accounted for separately as derivatives if recognising both the derivative and either the transferred asset or the liability arising from the transfer would result in recognising the same rights or obligations twice. For example, a call option retained by the transferor may prevent a transfer of financial assets from being accounted for as a sale. In that case, the call option is not separately recognised as a derivative asset.

AG36. To the extent that a transfer of a financial asset does not qualify for derecognition, the transferee does not recognise the transferred asset as its asset. The transferee derecognises the cash or other consideration paid and recognises a receivable from the transferor. If the transferor has both a right and an obligation to reacquire control of the entire transferred asset for a fixed amount (such as under a repurchase agreement), the transferee may measure its receivable at amortised cost if it meets the criteria in paragraph 40.

Examples

AG37. The following examples illustrate the application of the derecognition principles of this Standard.

(a) *Repurchase agreements and securities lending*. If a financial asset is sold under an agreement to repurchase it at a fixed price or at the sale price plus a lender's return or if it is loaned under an agreement to return it to the transferor, it is not derecognised because the transferor retains substantially all the risks and rewards of ownership. If the transferee obtains the right to sell or pledge the asset, the transferor reclassifies the asset in its statement of financial position, for example, as a loaned asset or repurchase receivable.

(b) *Repurchase agreements and securities lending—assets that are substantially the same*. If a financial asset is sold under an agreement to repurchase the same or substantially the same asset at a fixed price or at the sale price plus a lender's return or if a financial asset is borrowed or loaned under an agreement to return the same or substantially the same asset to the transferor, it is not derecognised because the transferor retains substantially all the risks and rewards of ownership.

(c) *Repurchase agreements and securities lending—right of substitution*. If a repurchase agreement at a fixed repurchase price or a price equal to the sale price plus a lender's return, or a similar securities lending transaction, provides the transferee with a right to substitute assets that are similar and of equal fair value to the transferred asset at the repurchase date, the asset sold or lent under a repurchase or securities lending transaction is not derecognised because the transferor retains substantially all the risks and rewards of ownership.

(d) *Repurchase right of first refusal at fair value*. If an entity sells a financial asset and retains only a right of first refusal to repurchase the transferred asset at fair value if the transferee subsequently sells it, the entity derecognises the asset because it has transferred substantially all the risks and rewards of ownership.

(e) *Wash sale transaction*. The repurchase of a financial asset shortly after it has been sold is sometimes referred to as a wash sale. Such a repurchase does not preclude derecognition provided that the original transaction met the derecognition requirements. However, if an agreement to sell a financial asset is entered into concurrently with an agreement to repurchase the same asset at a fixed price or the sale price plus a lender's return, then the asset is not derecognised.

(f) *Put options and call options that are deeply in the money*. If a transferred financial asset can be called back by the transferor and the call option is deeply in the money, the transfer does not qualify for derecognition because the transferor has retained substantially all the risks and rewards of ownership. Similarly, if the financial asset can be put back by the transferee and the put option is deeply in the money, the transfer does not qualify for derecognition because the transferor has retained substantially all the risks and rewards of ownership.

(g) *Put options and call options that are deeply out of the money*. A financial asset that is transferred subject only to a deep out-of-the-money put option held by the transferee or a deep out-of-the-money call option held by the transferor is derecognised. This is because the transferor has transferred substantially all the risks and rewards of ownership.

(h) *Readily obtainable assets subject to a call option that is neither deeply in the money nor deeply out of the money*. If an entity holds a call option on an asset that is readily obtainable in the market and the option is neither deeply in the money nor deeply out of the money, the asset is derecognised. This is because the entity (i) has neither retained nor transferred substantially all the risks and rewards of ownership, and (ii) has not retained control. However, if the asset is not readily obtainable in the market, derecognition is precluded to the extent of the amount of the asset that is subject to the call option because the entity has retained control of the asset.

(i) *A not readily obtainable asset subject to a put option written by an entity that is neither deeply in the money nor deeply out of the money*. If an entity transfers a financial asset that is not readily obtainable in the market, and writes a put option that is not deeply out of the money, the entity neither retains nor transfers substantially all the risks and rewards of ownership because of the written put option. The entity retains control of the asset if the put option is sufficiently valuable to prevent the transferee from selling the asset, in which case the asset continues to be recognised to the extent of the transferor's continuing involvement (see paragraph AG29). The entity transfers control of the asset if the put option is not sufficiently valuable to prevent the transferee from selling the asset, in which case the asset is derecognised.

(j) *Assets subject to a fair value put or call option or a forward repurchase agreement*. A transfer of a financial asset that is subject only to a put or call option or a forward repurchase agreement that has an exercise or repurchase price equal to the fair value of the financial asset at the time of repurchase results in derecognition because of the transfer of substantially all the risks and rewards of ownership.

(k) *Cash-settled call or put options*. An entity evaluates the transfer of a financial asset that is subject to a put or call option or a forward repurchase agreement that will be settled net in cash to determine whether it has retained or transferred substantially all the risks and rewards of ownership. If the entity has not retained substantially all the risks and rewards of ownership of the transferred asset, it determines whether it has retained control of the transferred asset. That the put or the call or the forward repurchase agreement is settled net in cash does not automatically mean that the entity has transferred control (see paragraphs AG29 and (g), (h) and (i) above).

(l) *Removal of accounts provision*. A removal of accounts provision is an unconditional repurchase (call) option that gives an entity the right to reclaim assets transferred subject to some restrictions. Provided that such an option results in the entity neither retaining nor transferring substantially all the risks and rewards of ownership, it precludes derecognition only to the extent of the amount subject to repurchase (assuming that the transferee cannot sell the assets). For example, if the carrying amount and proceeds from the transfer of loan assets are CU100,000 and any individual loan could be called back but the aggregate amount of loans that could be repurchased could not exceed CU10,000, CU90,000 of the loans would qualify for derecognition.

(m) *Clean-up calls*. An entity, which may be a transferor, that services transferred assets may hold a clean-up call to purchase remaining transferred assets when the amount of outstanding assets falls to a specified level at which the cost of servicing those assets becomes burdensome in relation to the benefits of servicing. Provided that such a clean-up call results in the entity neither retaining nor transferring substantially all the risks and rewards of ownership and the transferee cannot sell the assets, it precludes derecognition only to the extent of the amount of the assets that is subject to the call option.

(n) *Subordinated retained interests and credit guarantees*. An entity may provide the transferee with credit enhancement by subordinating some or all of its interest retained in the transferred asset. Alternatively, an entity may provide the transferee with credit enhancement in the form of a credit guarantee that could be unlimited or limited to a specified amount. If the entity retains substantially all the risks and rewards of ownership of the transferred asset, the asset continues to be recognised in its entirety. If the entity retains some, but not substantially all, of the risks and rewards of ownership and has retained control, derecognition is precluded to the extent of the amount of cash or other assets that the entity could be required to pay.

(o) *Total return swaps*. An entity may sell a financial asset to a transferee and enter into a total return swap with the transferee, whereby all of the interest payment cash flows from the underlying asset are remitted to the entity in exchange for a fixed payment or variable rate payment and any increases or declines in the fair value of the underlying asset are absorbed by the entity. In such a case, derecognition of all of the asset is prohibited.

(p) *Interest rate swaps*. An entity may transfer to a transferee a fixed rate financial asset and enter into an interest rate swap with the transferee to receive a fixed interest rate and pay a variable interest rate based on a notional amount that is equal to the principal amount of the transferred financial asset. The interest rate swap does not preclude derecognition of the transferred asset provided the payments on the swap are not conditional on payments being made on the transferred asset.

(q) *Amortising interest rate swaps*. An entity may transfer to a transferee a fixed rate financial asset that is paid off over time, and enter into an amortising interest rate swap with the transferee to receive a fixed interest rate and pay a variable interest rate based on a notional amount. If the notional amount of the swap amortises so that it equals the principal amount of the transferred financial asset outstanding at any point in time, the swap would generally result in the entity retaining substantial prepayment risk, in which case the entity either continues to recognise all of the transferred asset or continues to recognise the transferred asset to the extent of its continuing involvement. Conversely, if the amortisation of the notional amount of the swap is not linked to the principal amount outstanding of the transferred asset, such a swap would not result in the entity retaining prepayment risk on the asset. Hence, it would not preclude derecognition of the transferred asset provided the payments on the swap are not conditional on interest payments being made on the transferred asset and the swap does not result in the entity retaining any other significant risks and rewards of ownership on the transferred asset.

(r) *Write-off*. An entity has no reasonable expectations of recovering the contractual cash flows on a financial asset in its entirety or a portion thereof.

AG38. This paragraph illustrates the application of the continuing involvement approach when the entity's continuing involvement is in a part of a financial asset.

Assume an entity has a portfolio of prepayable loans whose coupon and effective interest rate is 10 per cent and whose principal amount and amortised cost is CU10,000. It enters into a transaction in which, in return for a payment of CU9,115, the transferee obtains the right to CU9,000 of any collections of principal plus interest thereon at 9.5 per cent. The entity retains rights to CU1,000 of any collections of principal plus interest thereon at 10 per cent, plus the excess spread of 0.5 per cent on the remaining CU9,000 of principal. Collections from prepayments are allocated between the entity and the transferee proportionately in the ratio of 1:9, but any defaults are deducted from the entity's interest of CU1,000 until that interest is exhausted. The fair value of the loans at the date of the transaction is CU10,100 and the estimated fair value of the excess spread of 0.5 per cent is CU40.

The entity determines that it has transferred some significant risks and rewards of ownership (for example, significant prepayment risk) but has also retained some significant risks and rewards of ownership (because of its subordinated retained interest) and has retained control. It therefore applies the continuing involvement approach.

To apply this Standard, the entity analyses the transaction as (a) a retention of a fully proportionate retained interest of CU1,000, plus (b) the subordination of that retained interest to provide credit enhancement to the transferee for credit losses.

The entity calculates that CU9,090 (90% × CU10,100) of the consideration received of CU9,115 represents the consideration for a fully proportionate 90 per cent share. The remainder of the consideration received (CU25) represents consideration received for subordinating its retained interest to provide credit enhancement to the transferee for credit losses. In addition, the excess spread of 0.5 per cent represents consideration received for the credit enhancement. Accordingly, the total consideration received for the credit enhancement is CU65 (CU25 + CU40).

The entity calculates the gain or loss on the sale of the 90 per cent share of cash flows. Assuming that separate fair values of the 90 per cent part transferred and the 10 per cent part retained are not available at the date of the transfer, the entity allocates the carrying amount of the asset in accordance with paragraph 25 as follows:

	Estimated fair value	*Percentage*	*Allocated carrying amount*
Portion transferred	9,090	90%	9,000
Portion retained	1,010	10%	1,000
Total	**10,100**		**10,000**

The entity computes its gain or loss on the sale of the 90 per cent share of the cash flows by deducting the allocated carrying amount of the portion transferred from the consideration received, i.e., CU90 (CU9,090 – CU9,000). The carrying amount of the portion retained by the entity is CU1,000.

In addition, the entity recognises the continuing involvement that results from the subordination of its retained interest for credit losses. Accordingly, it recognises an asset of CU1,000 (the maximum amount of the cash flows it would not receive under the subordination), and an associated liability of CU1,065 (which is the maximum amount of the cash flows it would not receive under the subordination, i.e., CU1,000 plus the fair value of the subordination of CU65).

The entity uses all of the above information to account for the transaction as follows:

	Debit	*Credit*
Original asset	—	9,000
Asset recognised for subordination or the residual interest	1,000	—
Asset for the consideration received in the form of excess spread	40	—
Surplus or deficit (gain on transfer)	—	90
Liability	—	1,065
Cash received	9,115	—
Total	**10,155**	**10,155**

Immediately following the transaction, the carrying amount of the asset is CU2,040 comprising CU1,000, representing the allocated cost of the portion retained, and CU1,040, representing the entity's additional continuing involvement from the subordination of its retained interest for credit losses (which includes the excess spread of CU40).

In subsequent periods, the entity recognises the consideration received for the credit enhancement (CU65) on a time proportion basis, accrues interest on the recognised asset using the effective interest method and recognises any impairment losses on the recognised assets. As an example of the latter, assume that in the following year there is an impairment loss on the underlying loans of CU300. The entity reduces its recognised asset by CU600 (CU300 relating to its retained interest and CU300 relating to the additional continuing involvement that arises from the subordination of its retained interest for impairment losses), and reduces its recognised liability by CU300. The net result is a charge to surplus or deficit for impairment losses of CU300.

Derecognition of Financial Liabilities

AG39. A financial liability (or part of it) is extinguished when the debtor either:

(a) Discharges the liability (or part of it) by paying the creditor, normally with cash, other financial assets, goods or services; or

(b) Is legally released from primary responsibility for the liability (or part of it) either by process of law or by the creditor. (If the debtor has given a guarantee this condition may still be met.)

AG40. If an issuer of a debt instrument repurchases that instrument, the debt is extinguished even if the issuer is a market maker in that instrument or intends to resell it in the near term.

AG41. Payment to a third party, including a trust (sometimes called 'in-substance defeasance'), does not, by itself, relieve the debtor of its primary obligation to the creditor, in the absence of legal release.

AG42. If a debtor pays a third party to assume an obligation and notifies its creditor that the third party has assumed its debt obligation, the debtor does not derecognise the debt obligation unless the condition in paragraph AG39(b) is met. If the debtor pays a third party to assume an obligation and obtains a legal release from its creditor, the debtor has extinguished the debt. However, if the debtor agrees to make payments on the debt to the third party or direct to its original creditor, the debtor recognises a new debt obligation to the third party.

AG43. If a third party assumes an obligation of an entity, and the entity provides either no or only nominal consideration to that third party in return, an entity applies the derecognition requirements of this Standard as well as paragraphs 84 to 87 of PBE IPSAS 23.

AG44. Lenders will sometimes waive their right to collect debt owed by a public sector entity, for example, a central government may cancel a loan owed by a local government. This waiver of debt would constitute a legal release of the debt owing by the borrower to the lender. Where an entity's obligations have been waived as part of a non-exchange transaction it applies the derecognition requirements of this Standard as well as paragraphs 84 to 87 of PBE IPSAS 23.

AG45. Although legal release, whether judicially or by the creditor, results in derecognition of a liability, the entity may recognise a new liability if the derecognition criteria in paragraphs 12–34 are not met for the financial assets transferred. If those criteria are not met, the transferred assets are not derecognised, and the entity recognises a new liability relating to the transferred assets.

AG46. For the purpose of paragraph 36, the terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10 per cent different from the discounted present value of the remaining cash flows of the original financial liability. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortised over the remaining term of the modified liability.

AG47. In some cases, a creditor releases a debtor from its present obligation to make payments, but the debtor assumes a guarantee obligation to pay if the party assuming primary responsibility defaults. In these circumstances the debtor:

(a) Recognises a new financial liability based on the fair value of its obligation for the guarantee; and

(b) Recognises a gain or loss based on the difference between (i) any proceeds paid and (ii) the carrying amount of the original financial liability less the fair value of the new financial liability.

Classification

Classification of Financial Assets

The Entity's Management Model for Financial Assets

AG48. Paragraph 39(a) requires an entity to classify financial assets on the basis of the entity's management model for the financial assets, unless paragraph 44 applies. An entity assesses whether its financial assets meet the condition in paragraph 40(a) or the condition in paragraph 41(a) on the basis of the management model as determined by the entity's key management personnel (as defined in PBE IPSAS 20 *Related Party Disclosures*).

AG49. An entity's management model is determined at a level that reflects how groups of financial assets are managed together to achieve a particular objective. The entity's management model does not depend on management's intentions for an individual instrument. Accordingly, this condition is not an instrument-by-instrument approach to classification and should be determined on a higher level of aggregation. However, a single entity may have more than one management model for its financial instruments. Consequently, classification need not be determined at the reporting entity level. For example, an entity may hold a portfolio of investments that it manages in order to collect contractual cash flows and another portfolio of investments that it manages in order to trade to realise fair value changes. Similarly, in some circumstances, it may be appropriate to separate a portfolio of financial assets into subportfolios in order to reflect the level at which an entity manages those financial assets. For example, that may be the case if an entity originates or purchases a portfolio of mortgage loans and manages some of the loans with an objective of collecting contractual cash flows and manages the other loans with an objective of selling them.

AG50. An entity's management model refers to how an entity manages its financial assets in order to generate cash flows. That is, the entity's management model determines whether cash flows will result from collecting contractual cash flows, selling financial assets or both. Consequently, this assessment is not performed on the basis of scenarios that the entity does not reasonably expect to occur, such as so-called 'worst case' or 'stress case' scenarios. For example, if an entity expects that it will sell a particular portfolio of financial assets only in a stress case scenario, that scenario would not affect the entity's assessment of the management model for those assets if the entity reasonably expects that such a scenario will not occur. If cash flows are realised in a way that is different from the entity's expectations at the date that the entity assessed the management model (for example, if the entity sells more or fewer financial assets than it expected when it classified the assets), that does not give rise to a prior period error in the entity's financial statements (see PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors*) nor does it change the classification of the remaining financial assets held in that management model (i.e., those assets that the entity recognised in prior periods and still holds) as long as the entity considered all relevant information that was available at the time that it made the management model assessment. However, when an entity assesses the management model for newly originated or newly purchased financial assets, it must consider information about how cash flows were realised in the past, along with all other relevant information.

AG51. An entity's management model for financial assets is a matter of fact and not merely an assertion. It is typically observable through the activities that the entity undertakes to achieve the objective of the management model. An entity will need to use judgement when it assesses its management model for financial assets and that assessment is not determined by a single factor or activity. Instead, the entity must consider all relevant evidence that is available at the date of the assessment. Such relevant evidence includes, but is not limited to:

(a) How the performance of the management model and the financial assets held within that management model are evaluated and reported to the entity's key management personnel;

(b) The risks that affect the performance of the management model (and the financial assets held within that management model) and, in particular, the way in which those risks are managed; and

(c) How management is compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected).

A Management Model Whose Objective is to Hold Assets in Order to Collect Contractual Cash Flows

AG52. Financial assets that are held within a management model whose objective is to hold assets in order to collect contractual cash flows are managed to realise cash flows by collecting contractual payments over the life of the instrument. That is, the entity manages the assets held within the portfolio to collect those particular contractual cash flows (instead of managing the overall return on the portfolio by both holding and selling assets). In determining whether cash flows are going to be realised by collecting the financial assets' contractual cash flows, it is necessary to consider the frequency, value and timing of sales in prior periods, the reasons for those sales and expectations about future sales activity. However sales in themselves do not determine the management model and therefore cannot be considered in isolation. Instead, information about past sales and expectations about future sales provide evidence related to how the entity's stated objective for managing the financial assets is achieved and, specifically, how cash flows are realised. An entity must consider information about past sales within the context of the reasons for those sales and the conditions that existed at that time as compared to current conditions.

AG53. Although the objective of an entity's management model may be to hold financial assets in order to collect contractual cash flows, the entity need not hold all of those instruments until maturity. Thus an entity's management model can be to hold financial assets to collect contractual cash flows even when sales of financial assets occur or are expected to occur in the future.

AG54. The management model may be to hold assets to collect contractual cash flows even if the entity sells financial assets when there is an increase in the assets' credit risk. To determine whether there has been an increase in the assets' credit risk, the entity considers reasonable and supportable information, including forward looking information. Irrespective of their frequency and value, sales due to an increase in the assets' credit risk are not inconsistent with a management model whose objective is to hold financial assets to collect contractual cash flows because the credit quality of financial assets is relevant to the entity's ability to collect contractual cash flows. Credit risk management activities that are aimed at minimising potential credit losses due to credit deterioration are integral to such a management model. Selling a financial asset because it no longer meets the credit criteria specified in the entity's documented investment policy is an example of a sale that has occurred due to an increase in credit risk. However, in the absence of such a policy, the entity may demonstrate in other ways that the sale occurred due to an increase in credit risk.

AG55. Sales that occur for other reasons, such as sales made to manage credit concentration risk (without an increase in the assets' credit risk), may also be consistent with a management model whose objective is to hold financial assets in order to collect contractual cash flows. In particular, such sales may be consistent with a management model whose objective is to hold financial assets in order to collect contractual cash flows if those sales are infrequent (even if significant in value) or insignificant in value both individually and in aggregate (even if frequent). If more than an infrequent number of such sales are made out of a portfolio and those sales are more than insignificant in value (either individually or in aggregate), the entity needs to assess whether and how such sales are consistent with an objective of collecting contractual cash flows. Whether a third party imposes the requirement to sell the financial assets, or that activity is at the entity's discretion, is not relevant to this assessment. An increase in the frequency or value of sales in a particular period is not necessarily inconsistent with an objective to hold financial assets in order to collect contractual cash flows, if an entity can explain the reasons for those sales and demonstrate why those sales do not reflect a change in the entity's management model. In addition, sales may be consistent with the objective of holding financial assets in order to collect contractual cash flows if the sales are made close to the maturity of the financial assets and the proceeds from the sales approximate the collection of the remaining contractual cash flows.

AG56. The following are examples of when the objective of an entity's management model may be to hold financial assets to collect the contractual cash flows. This list of examples is not exhaustive. Furthermore, the examples are not intended to discuss all factors that may be relevant to the assessment of the entity's management model nor specify the relative importance of the factors.

Example	Analysis
Example 1 An entity holds investments to collect their contractual cash flows. The funding needs of the entity are predictable and the maturity of its financial assets is matched to the entity's estimated funding needs. The entity performs credit risk management activities with the objective of minimising credit losses. In the past, sales have typically occurred when the financial assets' credit risk has increased such that the assets no longer meet the credit criteria specified in the entity's documented investment policy. In addition, infrequent sales have occurred as a result of unanticipated funding needs. Reports to key management personnel focus on the credit quality of the financial assets and the contractual return. The entity also monitors fair values of the financial assets, among other information.	Although the entity considers, among other information, the financial assets' fair values from a liquidity perspective (i.e., the cash amount that would be realised if the entity needs to sell assets), the entity's objective is to hold the financial assets in order to collect the contractual cash flows. Sales would not contradict that objective if they were in response to an increase in the assets' credit risk, for example if the assets no longer meet the credit criteria specified in the entity's documented investment policy. Infrequent sales resulting from unanticipated funding needs (e.g., in a stress case scenario) also would not contradict that objective, even if such sales are significant in value.
Example 2 An entity's management model is to purchase portfolios of financial assets, such as loans. Those portfolios may or may not include financial assets that are credit-impaired. If payment on the loans is not made on a timely basis, the entity attempts to realise the contractual cash flows through various means—for example, by contacting the debtor by mail, telephone or other methods. The entity's objective is to collect the contractual cash flows and the entity does not manage any of the loans in this portfolio with an objective of realising cash flows by selling them. In some cases, the entity enters into interest rate swaps to change the interest rate on particular financial assets in a portfolio from a floating interest rate to a fixed interest rate.	The objective of the entity's management model is to hold the financial assets in order to collect the contractual cash flows. The same analysis would apply even if the entity does not expect to receive all of the contractual cash flows (e.g., some of the financial assets are credit-impaired at initial recognition). Moreover, the fact that the entity enters into derivatives to modify the cash flows of the portfolio does not in itself change the entity's management model.

Example	Analysis
Example 3 An entity has a management model with the objective of originating student loans and subsequently selling those loans to a securitisation vehicle. The securitisation vehicle issues instruments to investors. The originating entity controls the securitisation vehicle and thus consolidates it. The securitisation vehicle collects the contractual cash flows from the loans and passes them on to its investors. It is assumed for the purposes of this example that the loans continue to be recognised in the consolidated statement of financial position because they are not derecognised by the securitisation vehicle.	The consolidated economic entity originated the loans with the objective of holding them to collect the contractual cash flows. However, the originating entity has an objective of realising cash flows on the loan portfolio by selling the loans to the securitisation vehicle, so for the purposes of its separate financial statements it would not be considered to be managing this portfolio in order to collect the contractual cash flows.
Example 4 A local government entity that issues bonds holds financial assets to meet redemption needs in a 'stress case' scenario (e.g., a run on the government's issued securities). The entity does not anticipate selling these assets except in such scenarios. The entity monitors the credit quality of the financial assets and its objective in managing the financial assets is to collect the contractual cash flows. The entity evaluates the performance of the assets on the basis of interest revenue earned and credit losses realised. However, the entity also monitors the fair value of the financial assets from a liquidity perspective to ensure that the cash amount that would be realised if the entity needed to sell the assets in a stress case scenario would be sufficient to meet the entity's liquidity needs. Periodically, the entity makes sales that are insignificant in value to demonstrate liquidity.	The objective of the entity's management model is to hold the financial assets to collect contractual cash flows. The analysis would not change even if during a previous stress case scenario the entity had sales that were significant in value in order to meet its redemption needs. Similarly, recurring sales activity that is insignificant in value is not inconsistent with holding financial assets to collect contractual cash flows. In contrast, if an entity holds financial assets to meet its everyday redemption needs and meeting that objective involves frequent sales that are significant in value, the objective of the entity's management model is not to hold the financial assets to collect contractual cash flows. Similarly, if the entity is required by law or regulation to routinely sell financial assets to demonstrate that the assets are liquid, and the value of the assets sold is significant, the entity's management model is not to hold financial assets to collect contractual cash flows. Whether a third party imposes the requirement to sell the financial assets, or that activity is at the entity's discretion, is not relevant to the analysis.

A Management Model Whose Objective is Achieved by Both Collecting Contractual Cash Flows and Selling Financial Assets

AG57. An entity may hold financial assets in a management model whose objective is achieved by both collecting contractual cash flows and selling financial assets. In this type of management model, the entity's key management personnel have made a decision that both collecting contractual cash flows and selling financial assets are integral to achieving the objective of the management model. There are various objectives that may be consistent with this type of management model. For example, the objective of the management model may be to manage everyday liquidity needs, to maintain a particular interest yield profile or to match the duration of the financial assets to the duration of the liabilities that those assets are funding. To achieve such an objective, the entity will both collect contractual cash flows and sell financial assets.

AG58. Compared to a management model whose objective is to hold financial assets to collect contractual cash flows, this management model will typically involve greater frequency and value of sales. This is because selling financial assets is integral to achieving the management model's objective instead of being only incidental to it. However, there is no threshold for the frequency or value of sales that must occur in this management model because both collecting contractual cash flows and selling financial assets are integral to achieving its objective.

AG59. The following are examples of when the objective of the entity's management model may be achieved by both collecting contractual cash flows and selling financial assets. This list of examples is not exhaustive. Furthermore, the examples are not intended to describe all the factors that may be relevant to the assessment of the entity's management model nor specify the relative importance of the factors.

Example	Analysis
Example 5 An entity anticipates capital expenditure in a few years. The entity invests its excess cash in short and long-term financial assets so that it can fund the expenditure when the need arises. Many of the financial assets have contractual lives that exceed the entity's anticipated investment period. The entity will hold financial assets to collect the contractual cash flows and, when an opportunity arises, it will sell financial assets to re-invest the cash in financial assets with a higher return. The managers responsible for the portfolio are remunerated based on the overall return generated by the portfolio.	The objective of the management model is achieved by both collecting contractual cash flows and selling financial assets. The entity will make decisions on an ongoing basis about whether collecting contractual cash flows or selling financial assets will maximise the return on the portfolio until the need arises for the invested cash. In contrast, consider an entity that anticipates a cash outflow in five years to fund capital expenditure and invests excess cash in short-term financial assets. When the investments mature, the entity reinvests the cash in new short-term financial assets. The entity maintains this strategy until the funds are needed, at which time the entity uses the proceeds from the maturing financial assets to fund the capital expenditure. Only sales that are insignificant in value occur before maturity (unless there is an increase in credit risk). The objective of this contrasting management model is to hold financial assets to collect contractual cash flows.
Example 6 An entity holds financial assets to meet its everyday liquidity needs. The entity seeks to minimise the costs of managing those liquidity needs and therefore actively manages the return on the portfolio. That return consists of collecting contractual payments as well as gains and losses from the sale of financial assets. As a result, the entity holds financial assets to collect contractual cash flows and sells financial assets to reinvest in higher yielding financial assets or to better match the duration of its liabilities. In the past, this strategy has resulted in frequent sales activity and such sales have been significant in value. This activity is expected to continue in the future.	The objective of the management model is to maximise the return on the portfolio to meet everyday liquidity needs and the entity achieves that objective by both collecting contractual cash flows and selling financial assets. In other words, both collecting contractual cash flows and selling financial assets are integral to achieving the management model's objective.

Example	Analysis
Example 7 A social security fund holds financial assets in order to fund social security liabilities. The fund uses the proceeds from the contractual cash flows on the financial assets to settle social security liabilities as they come due. To ensure that the contractual cash flows from the financial assets are sufficient to settle those liabilities, the fund undertakes significant buying and selling activity on a regular basis to rebalance its portfolio of assets and to meet cash flow needs as they arise.	The objective of the management model is to fund the social security liabilities. To achieve this objective, the entity collects contractual cash flows as they come due and sells financial assets to maintain the desired profile of the asset portfolio. Thus both collecting contractual cash flows and selling financial assets are integral to achieving the management model's objective.

Other Management Models

AG60. Financial assets are measured at fair value through surplus or deficit if they are not held within a management model whose objective is to hold assets to collect contractual cash flows or within a management model whose objective is achieved by both collecting contractual cash flows and selling financial assets (but see also paragraph 106). One management model that results in measurement at fair value through surplus or deficit is one in which an entity manages the financial assets with the objective of realising cash flows through the sale of the assets. The entity makes decisions based on the assets' fair values and manages the assets to realise those fair values. In this case, the entity's objective will typically result in active buying and selling. Even though the entity will collect contractual cash flows while it holds the financial assets, the objective of such a management model is not achieved by both collecting contractual cash flows and selling financial assets. This is because the collection of contractual cash flows is not integral to achieving the management model's objective; instead, it is incidental to it.

AG61. A portfolio of financial assets that is managed and whose performance is evaluated on a fair value basis (as described in paragraph 46(b)) is neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets. The entity is primarily focused on fair value information and uses that information to assess the assets' performance and to make decisions. In addition, a portfolio of financial assets that meets the definition of held for trading is not held to collect contractual cash flows or held both to collect contractual cash flows and to sell financial assets. For such portfolios, the collection of contractual cash flows is only incidental to achieving the management model's objective. Consequently, such portfolios of financial assets must be measured at fair value through surplus or deficit.

Contractual Cash Flows That are Solely Payments of Principal and Interest on the Principal Amount Outstanding

AG62. Paragraph 39(b) requires an entity to classify a financial asset on the basis of its contractual cash flow characteristics if the financial asset is held within a management model whose objective is to hold assets to collect contractual cash flows or within a management model whose objective is achieved by both collecting contractual cash flows and selling financial assets, unless paragraph 44 applies. To do so, the condition in paragraphs 40(b) and 41(b) requires an entity to determine whether the asset's contractual cash flows are solely payments of principal and interest on the principal amount outstanding.

AG63. 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 AG67–AG71) 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, commodity prices, a specific profitability or income threshold being reached by the borrower or lender, or the achievement (or otherwise) of specific financial or other ratios, 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.

AG64. In accordance with paragraph 42(a), principal is the fair value of the financial asset at initial recognition. However that principal amount may change over the life of the financial asset (for example, if there are repayments of principal).

AG65. An entity shall assess whether contractual cash flows are solely payments of principal and interest on the principal amount outstanding for the currency in which the financial asset is denominated.

AG66. Leverage is a contractual cash flow characteristic of some financial assets. Leverage increases the variability of the contractual cash flows with the result that they do not have the economic characteristics of interest. Stand-alone option, forward and swap contracts are examples of financial assets that include such leverage. Thus, such contracts do not meet the condition in paragraphs 40(b) and 41(b) and cannot be subsequently measured at amortised cost or fair value through other comprehensive revenue and expense.

Consideration for the Time Value of Money

AG67. Time value of money is the element of interest that provides consideration for only the passage of time. That is, the time value of money element does not provide consideration for other risks or costs associated with holding the financial asset. In order to assess whether the element provides consideration for only the passage of time, an entity applies judgement and considers relevant factors such as the currency in which the financial asset is denominated and the period for which the interest rate is set.

AG68. However, in some cases, the time value of money element may be modified (i.e., imperfect). That would be the case, for example, if a financial asset's interest rate is periodically reset but the frequency of that reset does not match the tenor of the interest rate (for example, the interest rate resets every month to a one-year rate) or if a financial asset's interest rate is periodically reset to an average of particular short- and long-term interest rates. In such cases, an entity must assess the modification to determine whether the contractual cash flows represent solely payments of principal and interest on the principal amount outstanding. In some circumstances, the entity may be able to make that determination by performing a qualitative assessment of the time value of money element whereas, in other circumstances, it may be necessary to perform a quantitative assessment.

AG69. When assessing a modified time value of money element, the objective is to determine how different the contractual (undiscounted) cash flows could be from the (undiscounted) cash flows that would arise if the time value of money element was not modified (the benchmark cash flows). For example, if the financial asset under assessment contains a variable interest rate that is reset every month to a one-year interest rate, the entity would compare that financial asset to a financial instrument with identical contractual terms and the identical credit risk except the variable interest rate is reset monthly to a one-month interest rate. If the modified time value of money element could result in contractual (undiscounted) cash flows that are significantly different from the (undiscounted) benchmark cash flows, the financial asset does not meet the condition in paragraphs 40(b) and 41(b). To make this determination, the entity must consider the effect of the modified time value of money element in each reporting period and cumulatively over the life of the financial instrument. The reason for the interest rate being set in this way is not relevant to the analysis. If it is clear, with little or no analysis, whether the contractual (undiscounted) cash flows on the financial asset under the assessment could (or could not) be significantly different from the (undiscounted) benchmark cash flows, an entity need not perform a detailed assessment.

AG70. When assessing a modified time value of money element, an entity must consider factors that could affect future contractual cash flows. For example, if an entity is assessing a bond with a five-year term and the variable interest rate is reset every six months to a five-year rate, the entity cannot conclude that the contractual cash flows are solely payments of principal and interest on the principal amount outstanding simply because the interest rate curve at the time of the assessment is such that the difference between a five-year interest rate and a six-month interest rate is not significant. Instead, the entity must also consider whether the relationship between the five-year interest rate and the six-month interest rate could change over the life of the instrument such that the contractual (undiscounted) cash flows over the life of the instrument could be significantly different from the (undiscounted) benchmark cash flows. However, an entity must consider only reasonably possible scenarios instead of every possible scenario. If an entity concludes that the contractual (undiscounted) cash flows could be significantly different from the (undiscounted) benchmark cash flows, the financial asset does not meet the condition in paragraphs 40(b) and 41(b) and therefore cannot be measured at amortised cost or fair value through other comprehensive revenue and expense.

AG71. In some jurisdictions, the government or a regulatory authority sets interest rates. For example, such government regulation of interest rates may be part of a broad macroeconomic policy or it may be introduced to encourage entities to invest in a particular sector of the economy. In some of these cases, the objective of the time value of money element is not to provide consideration for only the passage of time. However, despite paragraphs AG67–AG70, a regulated interest rate shall be considered a proxy for the time value of money element for the purpose of applying the condition in paragraphs 40(b) and 41(b) if that regulated interest rate provides consideration that is broadly consistent with the passage of time and does not provide exposure to risks or volatility in the contractual cash flows that are inconsistent with a basic lending arrangement.

Contractual Terms That Change the Timing or Amount of Contractual Cash Flows

AG72. 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. The entity may also need to assess the nature of any contingent event (i.e., 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. (See also paragraph AG80.)

AG73. The following are examples of contractual terms that result in contractual cash flows that are solely payments of principal and interest on the principal amount outstanding:

(a) A variable interest rate that consists of consideration for the time value of money, the credit risk associated with the principal amount outstanding during a particular period of time (the consideration for credit risk may be determined at initial recognition only, and so may be fixed) and other basic lending risks and costs, as well as a profit margin;

(b) A contractual term that permits the issuer (i.e., the debtor) to prepay a debt instrument or permits the holder (i.e., the creditor) to put a debt instrument back to the issuer before maturity and the prepayment amount substantially represents unpaid amounts of principal and interest on the principal amount outstanding, which may include reasonable compensation for the early termination of the contract; and

(c) A contractual term that permits the issuer or the holder to extend the contractual term of a debt instrument (i.e., an extension option) and the terms of the extension option result in contractual cash flows during the extension period that are solely payments of principal and interest on the principal amount outstanding, which may include reasonable additional compensation for the extension of the contract.

AG74. Despite paragraph AG72, a financial asset that would otherwise meet the condition in paragraphs 40(b) and 41(b) but does not do so only as a result of a contractual term that permits (or requires) the issuer to prepay a debt instrument or permits (or requires) the holder to put a debt instrument back to the issuer before maturity is eligible to be measured at amortised cost or fair value through other comprehensive revenue and expense (subject to meeting the condition in paragraph 40(a) or the condition in paragraph 41(a)) if:

(a) The entity acquires or originates the financial asset at a premium or discount to the contractual par amount;

(b) The prepayment amount substantially represents the contractual par amount and accrued (but unpaid) contractual interest, which may include reasonable compensation for the early termination of the contract; and

(c) When the entity initially recognises the financial asset, the fair value of the prepayment feature is insignificant.

AG74.1 For the purpose of applying paragraphs AG73(b) and AG74(b), irrespective of the event or circumstance that causes the early termination of the contract, a party may pay **or** receive reasonable compensation for that early termination. For example, a party may pay or receive reasonable compensation when it chooses to terminate the contract early (or otherwise causes the early termination to occur).

AG75. 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 A Instrument A is a bond with a stated maturity date. Payments of principal and interest on the principal amount outstanding are linked to an inflation index of the currency in which the instrument is issued. The inflation link is not leveraged and the principal is protected.	The contractual cash flows are solely payments of principal and interest on the principal amount outstanding. Linking payments of principal and interest on the principal amount outstanding to an unleveraged inflation index resets the time value of money to a current level. In other words, the interest rate on the instrument reflects ‘real’ interest. Thus, the interest amounts are consideration for the time value of money on the principal amount outstanding. However, if the interest payments were indexed to another variable such as the debtor’s performance (e.g., the debtor’s surplus or deficit) or an equity index, the contractual cash flows are not payments of principal and interest on the principal amount outstanding (unless the indexing to the debtor’s performance results in an adjustment that only compensates the holder for changes in the credit risk of the instrument, such that contractual cash flows are solely payments of principal and interest). That is because the contractual cash flows reflect a return that is inconsistent with a basic lending arrangement (see paragraph AG63).

Instrument	Analysis
Instrument B Instrument B is a variable interest rate instrument with a stated maturity date that permits the borrower to choose the market interest rate on an ongoing basis. For example, at each interest rate reset date, the borrower can choose to pay the three-month interbank offered rate for a three-month term or the one-month interbank offered rate for a one-month term.	The contractual cash flows are solely payments of principal and interest on the principal amount outstanding as long as the interest paid over the life of the instrument reflects consideration for the time value of money, for the credit risk associated with the instrument and for other basic lending risks and costs, as well as a profit margin (see paragraph AG63). The fact that the interbank offered interest rate is reset during the life of the instrument does not in itself disqualify the instrument. However, if the borrower is able to choose to pay a one-month interest rate that is reset every three months, the interest rate is reset with a frequency that does not match the tenor of the interest rate. Consequently, the time value of money element is modified. Similarly, if an instrument has a contractual interest rate that is based on a term that can exceed the instrument's remaining life (for example, if an instrument with a five-year maturity pays a variable rate that is reset periodically but always reflects a five-year maturity), the time value of money element is modified. That is because the interest payable in each period is disconnected from the interest period.
	In such cases, the entity must qualitatively or quantitatively assess the contractual cash flows against those on an instrument that is identical in all respects except the tenor of the interest rate matches the interest period to determine if the cash flows are solely payments of principal and interest on the principal amount outstanding. (But see paragraph AG71 for guidance on regulated interest rates.) For example, in assessing a bond with a five-year term that pays a variable rate that is reset every six months but always reflects a five-year maturity, an entity considers the contractual cash flows on an instrument that resets every six months to a six-month interest rate but is otherwise identical. The same analysis would apply if the borrower is able to choose between the lender's various published interest rates (e.g., the borrower can choose between the lender's published one-month variable interest rate and the lender's published three-month variable interest rate).

Instrument	Analysis
Instrument C Instrument C is a bond with a stated maturity date and pays a variable market interest rate. That variable interest rate is capped.	The contractual cash flows of both: (a) an instrument that has a fixed interest rate and (b) an instrument that has a variable interest rate are payments of principal and interest on the principal amount outstanding as long as the interest reflects consideration for the time value of money, for the credit risk associated with the instrument during the term of the instrument and for other basic lending risks and costs, as well as a profit margin. (See paragraph AG63) Consequently, an instrument that is a combination of (a) and (b) (e.g., a bond with an interest rate cap) can have cash flows that are solely payments of principal and interest on the principal amount outstanding. Such a contractual term may reduce cash flow variability by setting a limit on a variable interest rate (e.g., an interest rate cap or floor) or increase the cash flow variability because a fixed rate becomes variable.
Instrument D Instrument D is a full recourse loan and is secured by collateral.	The fact that a full recourse loan is collateralised does not in itself affect the analysis of whether the contractual cash flows are solely payments of principal and interest on the principal amount outstanding.
Instrument E Instrument E is issued by a regulated bank and has a stated maturity date. The instrument pays a fixed interest rate and all contractual cash flows are non-discretionary. However, the issuer is subject to legislation that permits or requires a national resolving authority to impose losses on holders of particular instruments, including Instrument E, in particular circumstances. For example, the national resolving authority has the power to write down the par amount of Instrument E or to convert it into a fixed number of the issuer's ordinary shares if the national resolving authority determines that the issuer is having severe financial difficulties, needs additional regulatory capital or is 'failing'.	The holder would analyse the contractual terms of the financial instrument to determine whether they give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding and thus are consistent with a basic lending arrangement. That analysis would not consider the payments that arise only as a result of the national resolving authority's power to impose losses on the holders of Instrument E. That is because that power, and the resulting payments, are not contractual terms of the financial instrument. In contrast, the contractual cash flows would not be solely payments of principal and interest on the principal amount outstanding if the contractual terms of the financial instrument permit or require the issuer or another entity to impose losses on the holder (e.g., by writing down the par amount or by converting the instrument into a fixed number of the issuer's ordinary shares) as long as those contractual terms are genuine, even if the probability is remote that such a loss will be imposed.

AG76. 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 F Instrument F is a bond that is convertible into a fixed number of equity instruments of the issuer.	The holder would analyse the convertible bond in its entirety. The contractual cash flows are not payments of principal and interest on the principal amount outstanding because they reflect a return that is inconsistent with a basic lending arrangement (see paragraph AG63); i.e., the return is linked to the value of the equity of the issuer.
Instrument G Instrument G is a loan that pays an inverse floating interest rate (i.e., the interest rate has an inverse relationship to market interest rates).	The contractual cash flows are not solely payments of principal and interest on the principal amount outstanding. The interest amounts are not consideration for the time value of money on the principal amount outstanding.
Instrument H Instrument H is a perpetual instrument but the issuer may call the instrument at any point and pay the holder the par amount plus accrued interest due. Instrument H pays a market interest rate but payment of interest cannot be made unless the issuer is able to remain solvent immediately afterwards. Deferred interest does not accrue additional interest.	The contractual cash flows are not payments of principal and interest on the principal amount outstanding. That is because the issuer may be required to defer interest payments and additional interest does not accrue on those deferred interest amounts. As a result, interest amounts are not consideration for the time value of money on the principal amount outstanding. If interest accrued on the deferred amounts, the contractual cash flows could be payments of principal and interest on the principal amount outstanding. The fact that Instrument H is perpetual does not in itself mean that the contractual cash flows are not payments of principal and interest on the principal amount outstanding. In effect, a perpetual instrument has continuous (multiple) extension options. Such options may result in contractual cash flows that are payments of principal and interest on the principal amount outstanding if interest payments are mandatory and must be paid in perpetuity. Also, the fact that Instrument H is callable does not mean that the contractual cash flows are not payments of principal and interest on the principal amount outstanding unless it is callable at an amount that does not substantially reflect payment of outstanding principal and interest on that principal amount outstanding. Even if the callable amount includes an amount that reasonably compensates the holder for the early termination of the instrument, the contractual cash flows could be payments of principal and interest on the principal amount outstanding. (See also paragraph AG74.)

AG77. 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 40(b), 41(b) and 42 of this Standard.

AG78. 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 40(b) and 41(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).

AG79. However, the fact that a financial asset is non-recourse does not in itself necessarily preclude the financial asset from meeting the condition in paragraphs 40(b) and 41(b). In such situations, the creditor is required to assess ('look through to') the particular underlying assets or cash flows to determine whether the contractual cash flows of the financial asset being classified are payments of principal and interest on the principal amount outstanding. 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 40(b) and 41(b). Whether the underlying assets are financial assets or non-financial assets does not in itself affect this assessment.

AG80. A contractual cash flow characteristic does not affect the classification of the financial asset if it could have only a de minimis effect on the contractual cash flows of the financial asset. To make this determination, an entity must consider the possible effect of the contractual cash flow characteristic in each reporting period and cumulatively over the life of the financial instrument. In addition, if a contractual cash flow characteristic could have an effect on the contractual cash flows that is more than de minimis (either in a single reporting period or cumulatively) but that cash flow characteristic is not genuine, it does not affect the classification of a financial asset. A cash flow characteristic is not genuine if it affects the instrument's contractual cash flows only on the occurrence of an event that is extremely rare, highly abnormal and very unlikely to occur.

AG81. In almost every lending transaction the creditor's instrument is ranked relative to the instruments of the debtor's other creditors. An instrument that is subordinated to other instruments may have contractual cash flows that are payments of principal and interest on the principal amount outstanding if the debtor's non-payment is a breach of contract and the holder has a contractual right to unpaid amounts of principal and interest on the principal amount outstanding even in the event of the debtor's bankruptcy. For example, a trade receivable that ranks its creditor as a general creditor would qualify as having payments of principal and interest on the principal amount outstanding. This is the case even if the debtor issued loans that are collateralised, which in the event of bankruptcy would give that loan holder priority over the claims of the general creditor in respect of the collateral but does not affect the contractual right of the general creditor to unpaid principal and other amounts due.

Contractually Linked Instruments

AG82. In some types of transactions, 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 are allocated to the tranche. 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.

AG83. In such transactions, a tranche has cash flow characteristics that are payments of principal and interest on the principal amount outstanding only if:

(a) The contractual terms of the tranche being assessed for classification (without looking through to the underlying pool of financial instruments) give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding (e.g., the interest rate on the tranche is not linked to a commodity index);

(b) The underlying pool of financial instruments has the cash flow characteristics set out in paragraphs AG85 and AG86; and

(c) The exposure to credit risk in the underlying pool of financial instruments inherent in the tranche is equal to or lower than the exposure to credit risk of the underlying pool of financial instruments (for example, the credit rating of the tranche being assessed for classification is equal to or higher than the credit rating that would apply to a single tranche that funded the underlying pool of financial instruments).

AG84. 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.

AG85. 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.

AG86. The underlying pool of instruments may also include instruments that:

(a) Reduce the cash flow variability of the instruments in paragraph AG85 and, when combined with the instruments in paragraph AG85, result in cash flows that are solely payments of principal and interest on the principal amount outstanding (e.g., an interest rate cap or floor or a contract that reduces the credit risk on some or all of the instruments in paragraph AG85); or

(b) Align the cash flows of the tranches with the cash flows of the pool of underlying instruments in paragraph AG85 to address differences in and only in:

(i) Whether the interest rate is fixed or floating;

(ii) The currency in which the cash flows are denominated, including inflation in that currency; or

(iii) The timing of the cash flows.

AG87. If any instrument in the pool does not meet the conditions in either paragraph AG85 or paragraph AG86, the condition in paragraph 83(b) is not met. In performing this assessment, a detailed instrument-by-instrument analysis of the pool may not be necessary. However, an entity must use judgement and perform sufficient analysis to determine whether the instruments in the pool meet the conditions in paragraphs AG85–AG86. (See also paragraph AG80 for guidance on contractual cash flow characteristics that have only a de minimis effect.)

AG88. If the holder cannot assess the conditions in paragraph AG83 at initial recognition, the tranche must be measured at fair value through surplus or deficit. If the underlying pool of instruments can change after initial recognition in such a way that the pool may not meet the conditions in paragraphs A85–AG86, the tranche does not meet the conditions in paragraph AG83 and must be measured at fair value through surplus or deficit. However, if the underlying pool includes instruments that are collateralised by assets that do not meet the conditions in paragraphs AG85–AG86, the ability to take possession of such assets shall be disregarded for the purposes of applying this paragraph unless the entity acquired the tranche with the management model of controlling the collateral.

Option to Designate a Financial Asset or Financial Liability as at Fair Value Through Surplus or Deficit

AG89. Subject to the conditions in paragraphs 44 and 46, this Standard allows an entity to designate a financial asset, a financial liability, or a group of financial instruments (financial assets, financial liabilities or both) as at fair value through surplus or deficit provided that doing so results in more relevant information.

AG90. The decision of an entity to designate a financial asset or financial liability as at fair value through surplus or deficit is similar to an accounting policy choice (although, unlike an accounting policy choice, it is not required to be applied consistently to all similar transactions). When an entity has such a choice, paragraph 12 of PBE IPSAS 3 requires the chosen policy to result in the financial statements providing faithfully representative and more relevant information about the effects of transactions, other events and conditions on the entity’s financial position, financial performance or cash flows. For example, in the case of designation of a financial liability as at fair value through surplus or deficit, paragraph 46 sets out the two circumstances when the requirement for more relevant information will be met. Accordingly, to choose such designation in accordance with paragraph 46, the entity needs to demonstrate that it falls within one (or both) of these two circumstances.

Designation Eliminates or Significantly Reduces an Accounting Mismatch

AG91. Measurement of a financial asset or financial liability and classification of recognised changes in its value are determined by the item's classification and whether the item is part of a designated hedging relationship. Those requirements can create a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') when, for example, in the absence of designation as at fair value through surplus or deficit, a financial asset would be classified as subsequently measured at fair value through surplus or deficit and a liability the entity considers related would be subsequently measured at amortised cost (with changes in fair value not recognised). In such circumstances, an entity may conclude that its financial statements would provide more relevant information if both the asset and the liability were measured as at fair value through surplus or deficit.

AG92. The following examples show when this condition could be met. In all cases, an entity may use this condition to designate financial assets or financial liabilities as at fair value through surplus or deficit only if it meets the principle in paragraph 44 or 46(a):

(a) An entity has liabilities under insurance contracts, whose measurement incorporates current information (as permitted by paragraph 24 of PBE IFRS 4) and financial assets that it considers to be related and that would otherwise be measured at either fair value through other comprehensive revenue and expense or amortised cost.

(b) An entity has financial assets, financial liabilities or both that share a risk, such as interest rate risk, and that gives rise to opposite changes in fair value that tend to offset each other. However, only some of the instruments would be measured at fair value through surplus or deficit (for example, those that are derivatives, or are classified as held for trading). It may also be the case that the requirements for hedge accounting are not met because, for example, the requirements for hedge effectiveness in paragraph 129 are not met.

(c) An entity has financial assets, financial liabilities or both that share a risk, such as interest rate risk, that gives rise to opposite changes in fair value that tend to offset each other and none of the financial assets or financial liabilities qualifies for designation as a hedging instrument because they are not measured at fair value through surplus or deficit. Furthermore, in the absence of hedge accounting there is a significant inconsistency in the recognition of gains and losses. For example, the entity has financed a specified group of loans by issuing traded bonds whose changes in fair value tend to offset each other. If, in addition, the entity regularly buys and sells the bonds but rarely, if ever, buys and sells the loans, reporting both the loans and the bonds at fair value through surplus or deficit eliminates the inconsistency in the timing of the recognition of the gains and losses that would otherwise result from measuring them both at amortised cost and recognising a gain or loss each time a bond is repurchased.

AG93. In cases such as those described in the preceding paragraph, to designate, at initial recognition, the financial assets and financial liabilities not otherwise so measured as at fair value through surplus or deficit may eliminate or significantly reduce the measurement or recognition inconsistency and produce more relevant information. For practical purposes, the entity need not enter into all of the assets and liabilities giving rise to the measurement or recognition inconsistency at exactly the same time. A reasonable delay is permitted provided that each transaction is designated as at fair value through surplus or deficit at its initial recognition and, at that time, any remaining transactions are expected to occur.

AG94. It would not be acceptable to designate only some of the financial assets and financial liabilities giving rise to the inconsistency as at fair value through surplus or deficit if to do so would not eliminate or significantly reduce the inconsistency and would therefore not result in more relevant information. However, it would be acceptable to designate only some of a number of similar financial assets or similar financial liabilities if doing so achieves a significant reduction (and possibly a greater reduction than other allowable designations) in the inconsistency. For example, assume an entity has a number of similar financial liabilities that sum to CU100 and a number of similar financial assets that sum to CU50 but are measured on a different basis. The entity may significantly reduce the measurement inconsistency by designating at initial recognition all of the assets but only some of the liabilities (for example, individual liabilities with a combined total of CU45) as at fair value through surplus or deficit. However, because designation as at fair value through surplus or deficit can be applied only to the whole of a financial instrument, the entity in this example must designate one or more liabilities in their entirety. It could not designate either a component of a liability (e.g., changes in value attributable to only one risk, such as changes in a benchmark interest rate) or a proportion (i.e., percentage) of a liability.

A Group of Financial Liabilities or Financial Assets and Financial Liabilities is Managed and its Performance is Evaluated on a Fair Value Basis

AG95. An entity may manage and evaluate the performance of a group of financial liabilities or financial assets and financial liabilities in such a way that measuring that group at fair value through surplus or deficit results in more relevant information. The focus in this instance is on the way the entity manages and evaluates performance, instead of on the nature of its financial instruments.

AG96. For example, an entity may use this condition to designate financial liabilities as at fair value through surplus or deficit if it meets the principle in paragraph 46(b) and the entity has financial assets and financial liabilities that share one or more risks and those risks are managed and evaluated on a fair value basis in accordance with a documented policy of asset and liability management. An example could be an entity that has issued 'structured products' containing multiple embedded derivatives and manages the resulting risks on a fair value basis using a mix of derivative and non-derivative financial instruments.

AG97. As noted above, this condition relies on the way the entity manages and evaluates performance of the group of financial instruments under consideration. Accordingly, (subject to the requirement of designation at initial recognition) an entity that designates financial liabilities as at fair value through surplus or deficit on the basis of this condition shall so designate all eligible financial liabilities that are managed and evaluated together.

AG98. Documentation of the entity's strategy need not be extensive but should be sufficient to demonstrate compliance with paragraph 46(b). Such documentation is not required for each individual item, but may be on a portfolio basis. For example, if the performance management system for a department—as approved by the entity's key management personnel—clearly demonstrates that its performance is evaluated on this basis, no further documentation is required to demonstrate compliance with paragraph 46(b).

Embedded Derivatives

AG99. When an entity becomes a party to a hybrid contract with a host that is not an asset within the scope of this Standard, paragraph 49 requires the entity to identify any embedded derivative, assess whether it is required to be separated from the host contract and, for those that are required to be separated, measure the derivatives at fair value at initial recognition and subsequently at fair value through surplus or deficit.

AG100. If a host contract has no stated or predetermined maturity and represents a residual interest in the net assets of an entity, then its economic characteristics and risks are those of an equity instrument, and an embedded derivative would need to possess equity characteristics related to the same entity to be regarded as closely related. If the host contract is not an equity instrument and meets the definition of a financial instrument, then its economic characteristics and risks are those of a debt instrument.

AG101. An embedded non-option derivative (such as an embedded forward or swap) is separated from its host contract on the basis of its stated or implied substantive terms, so as to result in it having a fair value of zero at initial recognition. An embedded option-based derivative (such as an embedded put, call, cap, floor or swaption) is separated from its host contract on the basis of the stated terms of the option feature. The initial carrying amount of the host instrument is the residual amount after separating the embedded derivative.

AG102. Generally, multiple embedded derivatives in a single hybrid contract are treated as a single compound embedded derivative. However, embedded derivatives that are classified as equity (see PBE IPSAS 28) are accounted for separately from those classified as assets or liabilities. In addition, if a hybrid contract has more than one embedded derivative and those derivatives relate to different risk exposures and are readily separable and independent of each other, they are accounted for separately from each other.

AG103. The economic characteristics and risks of an embedded derivative are not closely related to the host contract (paragraph 49(a)) in the following examples. In these examples, assuming the conditions in paragraph 49(b) and 49(c) are met, an entity accounts for the embedded derivative separately from the host contract.

(a) A put option embedded in an instrument that enables the holder to require the issuer to reacquire the instrument for an amount of cash or other assets that varies on the basis of the change in an equity or commodity price or index is not closely related to a host debt instrument.

(b) An option or automatic provision to extend the remaining term to maturity of a debt instrument is not closely related to the host debt instrument unless there is a concurrent adjustment to the approximate current market rate of interest at the time of the extension. If an entity issues a debt instrument and the holder of that debt instrument writes a call option on the debt instrument to a third party, the issuer regards the call option as extending the term to maturity of the debt instrument provided the issuer can be required to participate in or facilitate the remarketing of the debt instrument as a result of the call option being exercised.

(c) Equity-indexed interest or principal payments embedded in a host debt instrument or insurance contract—by which the amount of interest or principal is indexed to the value of equity instruments—are not closely related to the host instrument because the risks inherent in the host and the embedded derivative are dissimilar.

(d) Commodity-indexed interest or principal payments embedded in a host debt instrument or insurance contract—by which the amount of interest or principal is indexed to the price of a commodity (such as gold)—are not closely related to the host instrument because the risks inherent in the host and the embedded derivative are dissimilar.

(e) A call, put, or prepayment option embedded in a host debt contract or host insurance contract is not closely related to the host contract unless:

(i) The option's exercise price is approximately equal on each exercise date to the amortised cost of the host debt instrument or the carrying amount of the host insurance contract; or

(ii) The exercise price of a prepayment option reimburses the lender for an amount up to the approximate present value of lost interest for the remaining term of the host contract. Lost interest is the product of the principal amount prepaid multiplied by the interest rate differential. The interest rate differential is the excess of the effective interest rate of the host contract over the effective interest rate the entity would receive at the prepayment date if it reinvested the principal amount prepaid in a similar contract for the remaining term of the host contract.

The assessment of whether the call or put option is closely related to the host debt contract is made before separating the equity element of a convertible debt instrument in accordance with PBE IPSAS 28.

(f) Credit derivatives that are embedded in a host debt instrument and allow one party (the 'beneficiary') to transfer the credit risk of a particular reference asset, which it may not own, to another party (the 'guarantor') are not closely related to the host debt instrument. Such credit derivatives allow the guarantor to assume the credit risk associated with the reference asset without directly owning it.

AG104. An example of a hybrid contract is a financial instrument that gives the holder a right to put the financial instrument back to the issuer in exchange for an amount of cash or other financial assets that varies on the basis of the change in an equity or commodity index that may increase or decrease (a 'puttable instrument'). Unless the issuer on initial recognition designates the puttable instrument as a financial liability at fair value through surplus or deficit, it is required to separate an embedded derivative (i.e., the indexed principal payment) under paragraph 49 because the host contract is a debt instrument under paragraph AG100 and the indexed principal payment is not closely related to a host debt instrument under paragraph AG103(a). Because the principal payment can increase and decrease, the embedded derivative is a non-option derivative whose value is indexed to the underlying variable.

AG105. In the case of a puttable instrument that can be put back at any time for cash equal to a proportionate share of the net asset value of an entity (such as units of an open-ended mutual fund or some unit-linked investment products), the effect of separating an embedded derivative and accounting for each component is to measure the hybrid contract at the redemption amount that is payable at the end of the reporting period if the holder exercised its right to put the instrument back to the issuer.

AG106. The economic characteristics and risks of an embedded derivative are closely related to the economic characteristics and risks of the host contract in the following examples. In these examples, an entity does not account for the embedded derivative separately from the host contract.

(a) An embedded derivative in which the underlying is an interest rate or interest rate index that can change the amount of interest that would otherwise be paid or received on an interest-bearing host debt contract or insurance contract is closely related to the host contract unless the hybrid contract can be settled in such a way that the holder would not recover substantially all of its recognised investment or the embedded derivative could at least double the holder's initial rate of return on the host contract and could result in a rate of return that is at least twice what the market return would be for a contract with the same terms as the host contract.

(b) An embedded floor or cap on the interest rate on a debt contract or insurance contract is closely related to the host contract, provided the cap is at or above the market rate of interest and the floor is at or below the market rate of interest when the contract is issued, and the cap or floor is not leveraged in relation to the host contract. Similarly, provisions included in a contract to purchase or sell an asset (e.g., a commodity) that establish a cap and a floor on the price to be paid or received for the asset are closely related to the host contract if both the cap and floor were out of the money at inception and are not leveraged.

(c) An embedded foreign currency derivative that provides a stream of principal or interest payments that are denominated in a foreign currency and is embedded in a host debt instrument (for example, a dual currency bond) is closely related to the host debt instrument. Such a derivative is not separated from the host instrument because PBE IPSAS 4 *The Effects of Changes in Foreign Exchange Rates* requires foreign currency gains and losses on monetary items to be recognised in surplus or deficit.

(d) An embedded foreign currency derivative in a host contract that is an insurance contract or not a financial instrument (such as a contract for the purchase or sale of a non-financial item where the price is denominated in a foreign currency) is closely related to the host contract provided it is not leveraged, does not contain an option feature, and requires payments denominated in one of the following currencies:

  (i) The functional currency of any substantial party to that contract;

  (ii) The currency in which the price of the related good or service that is acquired or delivered is routinely denominated in commercial transactions around the world (such as the US dollar for crude oil transactions); or

  (iii) A currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place (e.g., a relatively stable and liquid currency that is commonly used in local business transactions or external trade).

(e) An embedded prepayment option in an interest-only or principal-only strip is closely related to the host contract provided the host contract (i) initially resulted from separating the right to receive contractual cash flows of a financial instrument that, in and of itself, did not contain an embedded derivative, and (ii) does not contain any terms not present in the original host debt contract.

(f) An embedded derivative in a host lease contract is closely related to the host contract if the embedded derivative is (i) an inflation-related index such as an index of lease payments to a consumer price index (provided that the lease is not leveraged and the index relates to inflation in the entity's own economic environment), (ii) variable lease payments based on related sales or (iii) variable lease payments based on variable interest rates.

(g) A unit-linking feature embedded in a host financial instrument or host insurance contract is closely related to the host instrument or host contract if the unit-denominated payments are measured at current unit values that reflect the fair values of the assets of the fund. A unit-linking feature is a contractual term that requires payments denominated in units of an internal or external investment fund.

(h) A derivative embedded in an insurance contract is closely related to the host insurance contract if the embedded derivative and host insurance contract are so interdependent that an entity cannot measure the embedded derivative separately (i.e., without considering the host contract).

Instruments Containing Embedded Derivatives

AG107. As noted in paragraph AG99, when an entity becomes a party to a hybrid contract with a host that is not an asset within the scope of this Standard and with one or more embedded derivatives, paragraph 49 requires the entity to identify any such embedded derivative, assess whether it is required to be separated from the host contract and, for those that are required to be separated, measure the derivatives at fair value at initial recognition and subsequently. These requirements can be more complex, or result in less reliable measures, than measuring the entire instrument at fair value through surplus or deficit. For that reason this Standard permits the entire hybrid contract to be designated as at fair value through surplus or deficit.

AG108. Such designation may be used whether paragraph 49 requires the embedded derivatives to be separated from the host contract or prohibits such separation. However, paragraph 51 would not justify designating the hybrid contract as at fair value through surplus or deficit in the cases set out in paragraph 51(a) and 51(b) because doing so would not reduce complexity or increase reliability.

Reassessment of Embedded Derivatives

AG109. In accordance with paragraph 49, an entity shall assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required. An entity determines whether a modification to cash flows is significant by considering the extent to which the expected future cash flows associated with the embedded derivative, the host contract or both have changed and whether the change is significant relative to the previously expected cash flows on the contract.

AG110. Paragraph AG109 does not apply to embedded derivatives in contracts acquired in:

(a) A business combination (as defined in PBE IFRS 3 *Business Combinations*);

(b) A combination of entities or businesses under common control as described in paragraphs B1- B4 of PBE IFRS 3; or

(c) The formation of a joint venture as defined in PBE IPSAS 37 *Joint Arrangements*

or their possible reassessment at the date of acquisition.

Reclassification of Financial Assets

AG111. Paragraph 54 requires an entity to reclassify financial assets if the entity changes its management model for managing those financial assets. Such changes are expected to be very infrequent. Such changes are determined by the entity's senior management as a result of external or internal changes and must be significant to the entity's operations and demonstrable to external parties. Accordingly, a change in an entity's management model will occur only when an entity either begins or ceases to perform an activity that is significant to its operations; for example, when the entity has acquired, disposed of or terminated a business line. Examples of a change in management model include the following:

(a) A government agency extends loans to small business owners and has a management model to sell the loan portfolios to private entities at a discount due to the long collection cycle of these loans. The entity enters into a long-term contract with a third-party collection service provider. The loan portfolios are no longer for sale, as they are held to collect the contractual cash flows with the aid of the collections service provider.

(b) A department of government decides to end its support for its national auto manufacturing industry by no longer providing favourable loans. That department no longer issues new loans and the department is actively marketing its loan portfolio for sale.

AG112. A change in the objective of the entity's management model must be effected before the reclassification date. For example, if a mortgage and housing corporation decides on February 15 to shut down its retail mortgage business and hence must reclassify all affected financial assets on April 1 (i.e., the first day of the entity's next reporting period), the entity must not accept new retail mortgage business or otherwise engage in activities consistent with its former management model after February 15.

AG113. The following are not changes in management model:

(a) A change in intention related to particular financial assets (even in circumstances of significant changes in market conditions).

(b) The temporary disappearance of a particular market for financial assets.

(c) A transfer of financial assets between parts of the entity with different management models.

Measurement

Non-Exchange Revenue Transactions

AG114. The initial recognition and measurement of assets and liabilities resulting from non-exchange revenue transactions is dealt with in PBE IPSAS 23. Assets resulting from non-exchange revenue transactions can arise out of both contractual and non-contractual arrangements (see PBE IPSAS 28 paragraphs AG20 and AG21). Where these assets arise out of contractual arrangements and otherwise meet the definition of a financial instrument, they are:

(a) Initially recognised in accordance with PBE IPSAS 23;

(b) Initially measured:

(i) At fair value using the principles in PBE IPSAS 23; and

(ii) Taking account of transaction costs that are directly attributable to the acquisition of the financial asset in accordance with paragraph 57 of this Standard, where the asset is subsequently measured other than at fair value through surplus or deficit.

Initial Measurement

Initial Measurement of Financial Assets and Financial Liabilities (paragraphs 57–59)

AG115. The fair value of a financial instrument at initial recognition is normally the transaction price (i.e., the fair value of the consideration given or received, see also paragraph AG117). However, if part of the consideration given or received is for something other than the financial instrument, the fair value of the financial instrument is estimated, using a valuation technique (see paragraphs AG149–AG154). For example, the fair value of a long-term loan or receivable that carries no interest can be measured as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating. Any additional amount lent is an expense or a reduction of revenue unless it qualifies for recognition as some other type of asset.

AG116. If an entity originates a loan that bears an off-market interest rate (e.g., 5 per cent when the market rate for similar loans is 8 per cent), and receives an upfront fee as compensation, the entity recognises the loan at its fair value, i.e., net of the fee it receives.

AG117. The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price. If an entity determines that the fair value at initial recognition differs from the transaction price as mentioned in paragraph 58, the entity shall account for that instrument at that date as follows:

(a) At the measurement required by paragraph 57 if that fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e., a Level 1 input) or based on a valuation technique that uses only data from observable markets. An entity shall recognise the difference between the fair value at initial recognition and the transaction price as a gain or loss.

(b) In all other cases, at the measurement required by paragraph 57, adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the entity shall recognise that deferred difference as a gain or loss only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the asset or liability.

The requirements of this paragraph do not apply to concessionary loans or equity instruments arising from non-exchange transactions as outlined in paragraphs AG118 to AG130.

Concessionary Loans

AG118. Concessionary loans are granted to or received by an entity at below market terms. Below market terms can result from interest and/or principal concessions. Examples of concessionary loans that commonly have below market terms include loans to developing countries, small farms, student loans granted to qualifying students for university or college education and housing loans granted to low income families. Entities may receive concessionary loans, for example, from development agencies and other government entities.

AG119. The granting or receiving of a concessionary loan is distinguished from the waiver of debt owing to or by an entity. This distinction is important because it affects whether the below market conditions are considered in the initial recognition or measurement of the loan rather than as part of the subsequent measurement or derecognition.

AG120. The intention of a concessionary loan at the outset is to provide or receive resources at below market terms. A waiver of debt results from loans initially granted or received at market related terms where the intention of either party to the loan has changed subsequent to its initial issue or receipt. For example, a government may lend money to a not-for-profit entity with the intention that the loan be repaid in full on market terms. However, the government may subsequently write-off part of the loan. This is not a concessionary loan as the intention of the loan at the outset was to provide credit to an entity at market related rates. An entity would treat the subsequent write-off of the loan as a waiver of debt and apply the derecognition requirements of PBE IPSAS 41 (see paragraphs 12–34).

AG121. Concessionary loans also share many characteristics with originated credit-impaired loans. Whether a loan is classified as concessionary or originated credit-impaired determines whether the difference between the transaction price and the fair value of the loan is recognised as a concession or as a credit loss in the statement of comprehensive revenue and expense.

AG122. Whether a loan is concessionary or originated credit-impaired depends on its substance. An intention to incorporate a non-exchange component into the transaction, such as a transfer of resources, indicates the loan is concessionary. The non-exchange component is incorporated into the transaction by granting the loan at below market terms. By contrast, originated credit-impaired loans are loans where one or more events, that have a detrimental impact on the estimated future cash flows of the financial asset, have occurred.

AG123. As concessionary loans are granted or received at below market terms, the transaction price on initial recognition of the loan may not be its fair value. At initial recognition, an entity therefore analyses the substance of the loan granted or received into its component parts, and accounts for those components using the principles in paragraphs AG124 and AG126 below.

AG124. An entity firstly assesses whether the substance of the concessionary loan is in fact a loan, a non-exchange transaction, a contribution from owners or a combination thereof, by applying the principles in PBE IPSAS 28 and paragraphs 42–58 of PBE IPSAS 23. If an entity has determined that the transaction, or part of the transaction, is a loan, it assesses whether the transaction price represents the fair value of the loan on initial recognition. An entity determines the fair value of the loan by using the principles in AG144–AG155. Where an entity cannot determine fair value by reference to an active market, it uses a valuation technique. Fair value using a valuation technique could be determined by discounting all future cash receipts using a market related rate of interest for a similar loan (see paragraph AG115).

AG125. Any difference between the fair value of the loan and the transaction price (the loan proceeds) is treated as follows:

(a) Where the loan is received by an entity, the difference is accounted for in accordance with PBE IPSAS 23.

(b) Where the loan is granted by an entity, the difference is treated as an expense in surplus or deficit at initial recognition, except where the loan is a transaction with owners, in their capacity as owners. Where the loan is a transaction with owners in their capacity as owners, for example, where a controlling entity provides a concessionary loan to a controlled entity, the difference may represent a capital contribution, i.e., an investment in an entity, rather than an expense.

Illustrative Examples are provided in paragraph IG54 of PBE IPSAS 23 as well as paragraphs IE153 to IE161 accompanying this Standard.

AG126. After evaluating the substance of the concessionary loan and measuring the loan component at fair value, an entity subsequently assesses the classification of concessionary loans in accordance with paragraphs 39–44 and measures concessionary loans in accordance with paragraphs 61–65.

AG127. In some circumstances a concessionary loan may be granted that is also originated credit-impaired. For example, a government may provide loans with concessionary terms on a recurring basis to a borrower that historically has not been able to repay in full. If the concessionary loan is credit-impaired, an entity measures the instrument at the fair value including the expected credit losses over the life of the instrument. An entity applies paragraph AG125(b) to account for the component parts and recognises the credit losses and concessionary element in its entirety as a concession.

Equity Instruments Arising from Non-Exchange Transactions

AG128. In the public sector, equity investment can be used as a way for an entity to provide financing or subsidised funding to another public sector entity. In such a transaction, there is generally a lack of an active market for such investments (i.e., the equity instrument is unquoted), and there are no or minimal future cash flow expectations from the investment besides a potential redemption by the issuing entity. Cash is provided by the investing entity to the investee generally to further the investee's economic or social objectives. Examples of such investments could include membership shares in a development bank, or equity investment in another public sector entity that provides certain social programs or services (e.g., shelters, subsidised housing, small business assistance...etc.)

AG129. At initial recognition of such transactions, an entity shall analyse the substance of the arrangement and assess whether the intention at the outset is the provision or receipt of resources by way of a non-exchange transaction. To the extent that the transaction, or component of the transaction, is a non-exchange transaction, any assets or revenues arising from the transaction are accounted for in accordance with PBE IPSAS 23. The entity providing the resources shall recognise the amount as an expense in surplus or deficit at initial recognition.

AG130. To the extent an equity instrument arises from the transaction, or component of the transaction, that is within the scope of this Standard, it is to be recognised initially at fair value in accordance with paragraph 57. The equity instrument is to be measured subsequently in accordance with paragraphs 61–63. If the instrument does not have an active market, the entity shall consider valuation techniques and inputs in paragraphs AG149–AG155) in determining its fair value.

Valuing Financial Guarantees Issued Through a Non-Exchange Transaction

AG131. Only contractual financial guarantees (or guarantees that are in substance, contractual) are within the scope of this Standard (See paragraphs AG3 and AG4 of PBE IPSAS 28). Non-contractual guarantees are not within the scope of this Standard as they do not meet the definition of a financial instrument. This Standard prescribes recognition and measurement requirements only for the issuer of financial guarantee contracts.

AG132. In paragraph 9, 'financial guarantee contract' is defined as "a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument." Under the requirements of this Standard, financial guarantee contracts, like other financial assets and financial liabilities, are required to be initially recognised at fair value. Paragraphs 66–68 of this Standard provide commentary and guidance on determining fair value and this is complemented by Application Guidance in paragraphs AG144–AG155. Subsequent measurement for financial guarantee contracts is at the higher of the amount of the loss allowance determined in accordance with paragraphs 73–93 and the amount initially recognised less, when appropriate, cumulative amortisation in accordance with PBE IPSAS 9.

AG133. In the public sector, guarantees are frequently provided by way of non-exchange transactions, i.e., at no or nominal consideration. This type of guarantee is provided generally to further the entity's economic and social objectives. Such purposes include supporting infrastructure projects, supporting corporate entities at times of economic distress, guaranteeing the bond issues of entities in other tiers of governments and the loans of employees to finance motor vehicles that are to be used for performance of their duties as employees. Where there is consideration for a financial guarantee, an entity should determine whether that consideration arises from an exchange transaction and whether the consideration represents a fair value. If the consideration does represent a fair value, entities should recognise the financial guarantee at the amount of the consideration. Subsequent measurement should be at the higher of the amount of the loss allowance determined in accordance with paragraphs 73–93 and the amount initially recognised, less, when appropriate, cumulative amortisation recognised in accordance with PBE IPSAS 9. Where the entity concludes that the consideration is not a fair value, an entity determines the carrying value at initial recognition in the same way as if no consideration had been paid.

AG134. At initial recognition, where no fee is charged or where the consideration is not fair value, an entity firstly considers whether there are quoted prices available in an active market for financial guarantee contracts directly equivalent to that entered into. Evidence of an active market includes recent arm's length market transactions between knowledgeable willing parties, and reference to the current fair value of another financial guarantee contract that is substantially the same as that provided at nil or nominal consideration by the issuer. The fact that a financial guarantee contract has been entered into at no consideration by the debtor to the issuer is not, of itself, conclusive evidence of the absence of an active market. Guarantees may be available from commercial issuers, but a public sector entity may agree to enter into a financial guarantee contract for a number of non-commercial reasons. For example, if a debtor is unable to afford a commercial fee, and initiation of a project in fulfilment of one of the entity's social or policy objectives would be put at risk unless a financial guarantee contract is issued, it may approach a public sector entity or government to issue a financial guarantee contract.

AG135. Where there is no active market for a directly equivalent guarantee contract; the entity considers whether a valuation technique other than observation of an active market is available and provides a reliable measure of fair value. Such a valuation technique may rely on mathematical models which consider financial risk. For example, Central Government W guarantees a bond issue of Municipality X. As Municipality X has a government guarantee backing its bond issue, its bonds have a lower coupon than if they were not secured by a government guarantee. This is because the guarantee lowers the risk profile of the bonds for investors. The guarantee fee could be determined by using the credit spread between what the coupon rate would have been had the issue not been backed by a government guarantee and the rate with the guarantee in place. Where a fair value is obtainable either by observation of an active market or through another valuation technique, the entity recognises the financial guarantee at that fair value in the statement of financial position and recognises an expense of an equivalent amount in the statement of comprehensive revenue and expense. When using a valuation technique that is not based on observation of an active market an entity needs to satisfy itself that the output of any model is reliable and understandable.

AG136. If no reliable measure of fair value can be determined, either by direct observation of an active market or through another valuation technique, an entity is required to measure the financial guarantee contract at the amount of the loss allowance determined in accordance with paragraphs 73 to 93.

Subsequent Measurement

AG137. If a financial instrument that was previously recognised as a financial asset is measured at fair value through surplus or deficit and its fair value decreases below zero, it is a financial liability measured in accordance with paragraph 45. However, hybrid contracts with hosts that are assets within the scope of this Standard are always measured in accordance with paragraph 48.

AG138. The following example illustrates the accounting for transaction costs on the initial and subsequent measurement of a financial asset measured at fair value with changes through other comprehensive revenue and expense in accordance with either paragraph 106 or 41. An entity acquires a financial asset for CU100 plus a purchase commission of CU2. Initially, the entity recognises the asset at CU102. The reporting period ends one day later, when the quoted market price of the asset is CU100. If the asset were sold, a commission of CU3 would be paid. On that date, the entity measures the asset at CU100 (without regard to the possible commission on sale) and recognises a loss of CU2 in other comprehensive revenue and expense. If the financial asset is measured at fair value through other comprehensive revenue and expense in accordance with paragraph 41, the transaction costs are amortised to surplus or deficit using the effective interest method.

AG139. The subsequent measurement of a financial asset or financial liability and the subsequent recognition of gains and losses described in paragraph AG117 shall be consistent with the requirements of this Standard.

Investments in Equity Instruments and Contracts on Those Investments

AG140. All investments in equity instruments and contracts on those instruments must be measured at fair value. However, in limited circumstances, cost may be an appropriate estimate of fair value. That may be the case if insufficient more recent information is available to measure fair value, or if there is a wide range of possible fair value measurements and cost represents the best estimate of fair value within that range.

AG141. Indicators that cost might not be representative of fair value include:

(a) A significant change in the performance of the investee compared with budgets, plans or milestones.

(b) Changes in expectation that the investee's technical product milestones will be achieved.

(c) A significant change in the market for the investee's equity or its products or potential products.

(d) A significant change in the global economy or the economic environment in which the investee operates.

(e) A significant change in the performance of comparable entities, or in the valuations implied by the overall market.

(f) Internal matters of the investee such as fraud, commercial disputes, litigation, changes in management or strategy.

(g) Evidence from external transactions in the investee's equity, either by the investee (such as a fresh issue of equity), or by transfers of equity instruments between third parties.

AG142. The list in paragraph AG141 is not exhaustive. An entity shall use all information about the performance and operations of the investee that becomes available after the date of initial recognition. To the extent that any such relevant factors exist, they may indicate that cost might not be representative of fair value. In such cases, the entity must measure fair value.

AG143. Cost is never the best estimate of fair value for investments in quoted equity instruments (or contracts on quoted equity instruments).

Fair Value Measurement Considerations

AG144. Underlying the definition of fair value is a presumption that an entity is a going concern without any intention or need to liquidate, to curtail materially the scale of its operations or to undertake a transaction on adverse terms. Fair value is not, therefore, the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale. However, fair value reflects the credit quality of the instrument.

AG145. This Standard uses the terms 'bid price' and 'asking price' (sometimes referred to as 'current offer price') in the context of quoted market prices, and the term 'the bid-ask spread' to include only transaction costs. Other adjustments to arrive at fair value (e.g., for counterparty credit risk) are not included in the term 'bid-ask spread.'

Active Market: Quoted Price

AG146. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. Fair value is defined in terms of a price agreed by a willing buyer and a willing seller in an arm's length transaction. The objective of determining fair value for a financial instrument that is traded in an active market is to arrive at the price at which a transaction would occur at the end of the reporting period in that instrument (i.e., without modifying or repackaging the instrument) in the most advantageous active market to which the entity has immediate access. However, the entity adjusts the price in the more advantageous market to reflect any differences in counterparty credit risk between instruments traded in that market and the one being valued. The existence of published price quotations in an active market is the best evidence of fair value and when they exist they are used to measure the financial asset or financial liability.

AG147. The appropriate quoted market price for an asset held or liability to be issued is usually the current bid price and, for an asset to be acquired or liability held, the asking price. When an entity has assets and liabilities with offsetting market risks, it may use mid-market prices as a basis for establishing fair values for the offsetting risk positions and apply the bid or asking price to the net open position as appropriate. When current bid and asking prices are unavailable, the price of the most recent transaction provides evidence of the current fair value as long as there has not been a significant change in economic circumstances since the time of the transaction. If conditions have changed since the time of the transaction (e.g., a change in the risk-free interest rate following the most recent price quote for a government bond), the fair value reflects the change in conditions by reference to current prices or rates for similar financial instruments, as appropriate. Similarly, if the entity can demonstrate that the last transaction price is not fair value (e.g., because it reflected the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale), that price is adjusted. The fair value of a portfolio of financial instruments is the product of the number of units of the instrument and its quoted market price. If a published price quotation in an active market does not exist for a financial instrument in its entirety, but active markets exist for its component parts, fair value is determined on the basis of the relevant market prices for the component parts.

AG148. If a rate (rather than a price) is quoted in an active market, the entity uses that market-quoted rate as an input into a valuation technique to determine fair value. If the market-quoted rate does not include credit risk or other factors that market participants would include in valuing the instrument, the entity adjusts for those factors.

No Active Market: Valuation Technique

AG149. If the market for a financial instrument is not active, an entity establishes fair value by using a valuation technique. Valuation techniques include using recent arm’s length market transactions between knowledgeable, willing parties, if available, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the entity uses that technique.

AG150. The objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm’s length exchange motivated by normal operating considerations. Fair value is estimated on the basis of the results of a valuation technique that makes maximum use of market inputs, and relies as little as possible on entity-specific inputs. A valuation technique would be expected to arrive at a realistic estimate of the fair value if (a) it reasonably reflects how the market could be expected to price the instrument and (b) the inputs to the valuation technique reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument.

AG151. Therefore, a valuation technique (a) incorporates all factors that market participants would consider in setting a price and (b) is consistent with accepted economic methodologies for pricing financial instruments. Periodically, an entity calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on any available observable market data. An entity obtains market data consistently in the same market where the instrument was originated or purchased.

AG152. The initial acquisition or origination of a financial asset or incurrence of a financial liability is a market transaction that provides a foundation for estimating the fair value of the financial instrument. In particular, if the financial instrument is a debt instrument (such as a loan), its fair value can be determined by reference to the market conditions that existed at its acquisition or origination date and current market conditions or interest rates currently charged by the entity or by others for similar debt instruments (i.e., similar remaining maturity, cash flow pattern, currency, credit risk, collateral and interest basis). Alternatively, provided there is no change in the credit risk of the debtor and applicable credit spreads after the origination of the debt instrument, an estimate of the current market interest rate may be derived by using a benchmark interest rate reflecting a better credit quality than the underlying debt instrument, holding the credit spread constant, and adjusting for the change in the benchmark interest rate from the origination date. If conditions have changed since the most recent market transaction, the corresponding change in the fair value of the financial instrument being valued is determined by reference to current prices or rates for similar financial instruments, adjusted as appropriate, for any differences from the instrument being valued.

AG153. The same information may not be available at each measurement date. For example, at the date that an entity makes a loan or acquires a debt instrument that is not actively traded, the entity has a transaction price that is also a market price. However, no new transaction information may be available at the next measurement date and, although the entity can determine the general level of market interest rates, it may not know what level of credit or other risk market participants would consider in pricing the instrument on that date. An entity may not have information from recent transactions to determine the appropriate credit spread over the basic interest rate to use in determining a discount rate for a present value computation. It would be reasonable to assume, in the absence of evidence to the contrary, that no changes have taken place in the spread that existed at the date the loan was made. However, the entity would be expected to make reasonable efforts to determine whether there is evidence that there has been a change in such factors. When evidence of a change exists, the entity would consider the effects of the change in determining the fair value of the financial instrument.

AG154. In applying discounted cash flow analysis, an entity uses one or more discount rates equal to the prevailing rates of return for financial instruments having substantially the same terms and characteristics, including the credit quality of the instrument, the remaining term over which the contractual interest rate is fixed, the remaining term to repayment of the principal and the currency in which payments are to be made.

Inputs to Valuation Techniques

AG155. An appropriate technique for estimating the fair value of a particular financial instrument would incorporate observable market data about the market conditions and other factors that are likely to affect the instrument's fair value. The fair value of a financial instrument will be based on one or more of the following factors (and perhaps others).

(a) The time value of money (i.e., interest at the basic or risk-free rate). Basic interest rates can usually be derived from observable government bond prices and are often quoted in financial publications. These rates typically vary with the expected dates of the projected cash flows along a yield curve of interest rates for different time horizons. For practical reasons, an entity may use a well-accepted and readily observable general market rate, such as a swap rate, as the benchmark rate. (If the rate used is not the risk-free interest rate, the credit risk adjustment appropriate to the particular financial instrument is determined on the basis of its credit risk in relation to the credit risk in this benchmark rate). In some countries, the central government's bonds may carry a significant credit risk and may not provide a stable benchmark basic interest rate for instruments denominated in that currency. Some entities in these countries may have a better credit standing and a lower borrowing rate than the central government. In such a case, basic interest rates may be more appropriately determined by reference to interest rates for the highest rated corporate bonds issued in the currency of that jurisdiction.

(b) Credit risk. The effect on fair value of credit risk (i.e., the premium over the basic interest rate for credit risk) may be derived from observable market prices for traded instruments of different credit quality or from observable interest rates charged by lenders for loans of various credit ratings.

(c) Foreign currency exchange prices. Active currency exchange markets exist for most major currencies, and prices are quoted daily in financial publications.

(d) Commodity prices. There are observable market prices for many commodities.

(e) Equity prices. Prices (and indexes of prices) of traded equity instruments are readily observable in some markets. Present value based techniques may be used to estimate the current market price of equity instruments for which there are no observable prices.

(f) Volatility (i.e., magnitude of future changes in price of the financial instrument or other item). Measures of the volatility of actively traded items can normally be reasonably estimated on the basis of historical market data or by using volatilities implied in current market prices.

(g) Prepayment risk and surrender risk. Expected prepayment patterns for financial assets and expected surrender patterns for financial liabilities can be estimated on the basis of historical data. (The fair value of a financial liability that can be surrendered by the counterparty cannot be less than the present value of the surrender amount – see paragraph 68).

(h) Servicing costs for a financial asset or a financial liability. Costs of servicing can be estimated using comparisons with current fees charged by other market participants. If the costs of servicing a financial asset or financial liability are significant and other market participants would face comparable costs, the issuer would consider them in determining the fair value of that financial asset or financial liability. It is likely that the fair value at inception of a contractual right to future fees equals the origination costs paid for them, unless future fees and related costs are out of line with market comparables.

Amortised Cost Measurement

Effective Interest Method

AG156. In applying the effective interest method, an entity identifies fees that are an integral part of the effective interest rate of a financial instrument. The description of fees for financial services may not be indicative of the nature and substance of the services provided. Fees that are an integral part of the effective interest rate of a financial instrument are treated as an adjustment to the effective interest rate, unless the financial instrument is measured at fair value, with the change in fair value being recognised in surplus or deficit. In those cases, the fees are recognised as revenue or expense when the instrument is initially recognised.

AG157. Fees that are an integral part of the effective interest rate of a financial instrument include:

(a) Origination fees received by the entity relating to the creation or acquisition of a financial asset. Such fees may include compensation for activities such as evaluating the borrower's financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction. These fees are an integral part of generating an involvement with the resulting financial instrument.

(b) Commitment fees received by the entity to originate a loan when the loan commitment is not measured in accordance with paragraph 45(a) and it is probable that the entity will enter into a specific lending arrangement. These fees are regarded as compensation for an ongoing involvement with the acquisition of a financial instrument. If the commitment expires without the entity making the loan, the fee is recognised as revenue on expiry.

(c) Origination fees paid on issuing financial liabilities measured at amortised cost. These fees are an integral part of generating an involvement with a financial liability. An entity distinguishes fees and costs that are an integral part of the effective interest rate for the financial liability from origination fees and transaction costs relating to the right to provide services, such as investment management services.

AG158. Fees that are not an integral part of the effective interest rate of a financial instrument and are accounted for in accordance with PBE IPSAS 9 include:

(a) Fees charged for servicing a loan;

(b) Commitment fees to originate a loan when the loan commitment is not measured in accordance with paragraph 45(a) and it is unlikely that a specific lending arrangement will be entered into; and

(c) Loan syndication fees received by an entity that arranges a loan and retains no part of the loan package for itself (or retains a part at the same effective interest rate for comparable risk as other participants).

AG159. When applying the effective interest method, an entity generally amortises any fees, points paid or received, transaction costs and other premiums or discounts that are included in the calculation of the effective interest rate over the expected life of the financial instrument. However, a shorter period is used if this is the period to which the fees, points paid or received, transaction costs, premiums or discounts relate. This will be the case when the variable to which the fees, points paid or received, transaction costs, premiums or discounts relate is repriced to market rates before the expected maturity of the financial instrument. In such a case, the appropriate amortisation period is the period to the next such repricing date. For example, if a premium or discount on a floating-rate financial instrument reflects the interest that has accrued on that financial instrument since the interest was last paid, or changes in the market rates since the floating interest rate was reset to the market rates, it will be amortised to the next date when the floating interest is reset to market rates. This is because the premium or discount relates to the period to the next interest reset date because, at that date, the variable to which the premium or discount relates (i.e., interest rates) is reset to the market rates. If, however, the premium or discount results from a change in the credit spread over the floating rate specified in the financial instrument, or other variables that are not reset to the market rates, it is amortised over the expected life of the financial instrument.

AG160. For floating-rate financial assets and floating-rate financial liabilities, periodic re-estimation of cash flows to reflect the movements in the market rates of interest alters the effective interest rate. If a floating-rate financial asset or a floating-rate financial liability is recognised initially at an amount equal to the principal receivable or payable on maturity, re-estimating the future interest payments normally has no significant effect on the carrying amount of the asset or the liability.

AG161. If an entity revises its estimates of payments or receipts (excluding modifications in accordance with paragraph 71 and changes in estimates of expected credit losses), it shall adjust the gross carrying amount of the financial asset or amortised cost of a financial liability (or group of financial instruments) to reflect actual and revised estimated contractual cash flows. The entity recalculates the gross carrying amount of the financial asset or amortised cost of the financial liability as the present value of the estimated future contractual cash flows that are discounted at the financial instrument's original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets) or, when applicable, the revised effective interest rate calculated in accordance with paragraph 139. The adjustment is recognised in surplus or deficit as revenue or expense.

AG162. In some cases a financial asset is considered credit-impaired at initial recognition because the credit risk is very high, and in the case of a purchase it is acquired at a deep discount. An entity is required to include the initial expected credit losses in the estimated cash flows when calculating the credit-adjusted effective interest rate for financial assets that are considered to be purchased or originated credit-impaired at initial recognition. However, this does not mean that a credit-adjusted effective interest rate should be applied solely because the financial asset has high credit risk at initial recognition.

Transaction Costs

AG163. Transaction costs include fees and commission paid to agents (including employees acting as selling agents), advisers, brokers and dealers, levies by regulatory agencies and security exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

Write-off

AG164. Write-offs can relate to a financial asset in its entirety or to a portion of it. For example, an entity plans to enforce the collateral on a financial asset and expects to recover no more than 30 per cent of the financial asset from the collateral. If the entity has no reasonable prospects of recovering any further cash flows from the financial asset, it should write off the remaining 70 per cent of the financial asset.

Impairment

Collective and Individual Assessment Basis

AG165 In order to meet the objective of recognising lifetime expected credit losses for significant increases in credit risk since initial recognition, it may be necessary to perform the assessment of significant increases in credit risk on a collective basis by considering information that is indicative of significant increases in credit risk on, for example, a group or sub-group of financial instruments. This is to ensure that an entity meets the objective of recognising lifetime expected credit losses when there are significant increases in credit risk, even if evidence of such significant increases in credit risk at the individual instrument level is not yet available.

AG166. Lifetime expected credit losses are generally expected to be recognised before a financial instrument becomes past due. Typically, credit risk increases significantly before a financial instrument becomes past due or other lagging borrower-specific factors (for example, a modification or restructuring) are observed. Consequently when reasonable and supportable information that is more forward-looking than past due information is available without undue cost or effort, it must be used to assess changes in credit risk.

AG167. However, depending on the nature of the financial instruments and the credit risk information available for particular groups of financial instruments, an entity may not be able to identify significant changes in credit risk for individual financial instruments before the financial instrument becomes past due. This may be the case for financial instruments such as student loans for which there is little or no updated credit risk information that is routinely obtained and monitored on an individual instrument until a borrower breaches the contractual terms. If changes in the credit risk for individual financial instruments are not captured before they become past due, a loss allowance based only on credit information at an individual financial instrument level would not faithfully represent the changes in credit risk since initial recognition.

AG168. In some circumstances an entity does not have reasonable and supportable information that is available without undue cost or effort to measure lifetime expected credit losses on an individual instrument basis. In that case, lifetime expected credit losses shall be recognised on a collective basis that considers comprehensive credit risk information. This comprehensive credit risk information must incorporate not only past due information but also all relevant credit information, including forward-looking macroeconomic information, in order to approximate the result of recognising lifetime expected credit losses when there has been a significant increase in credit risk since initial recognition on an individual instrument level.

AG169. For the purpose of determining significant increases in credit risk and recognising a loss allowance on a collective basis, an entity can group financial instruments on the basis of shared credit risk characteristics with the objective of facilitating an analysis that is designed to enable significant increases in credit risk to be identified on a timely basis. The entity should not obscure this information by grouping financial instruments with different risk characteristics. Examples of shared credit risk characteristics may include, but are not limited to, the:

(a) Instrument type;

(b) Credit risk ratings;

(c) Collateral type;

(d) Date of initial recognition;

(e) Remaining term to maturity;

(f) Industry;

(g) Geographical location of the borrower; and

(h) The value of collateral relative to the financial asset if it has an impact on the probability of a default occurring (for example, non-recourse loans in some jurisdictions or loan-to-value ratios).

AG170. Paragraph 76 requires that lifetime expected credit losses are recognised on all financial instruments for which there has been significant increases in credit risk since initial recognition. In order to meet this objective, if an entity is not able to group financial instruments for which the credit risk is considered to have increased significantly since initial recognition based on shared credit risk characteristics, the entity should recognise lifetime expected credit losses on a portion of the financial assets for which credit risk is deemed to have increased significantly. The aggregation of financial instruments to assess whether there are changes in credit risk on a collective basis may change over time as new information becomes available on groups of, or individual, financial instruments.

Timing of Recognising Lifetime Expected Credit Losses

AG171. The assessment of whether lifetime expected credit losses should be recognised is based on significant increases in the likelihood or risk of a default occurring since initial recognition (irrespective of whether a financial instrument has been repriced to reflect an increase in credit risk) instead of on evidence of a financial asset being credit-impaired at the reporting date or an actual default occurring. Generally, there will be a significant increase in credit risk before a financial asset becomes credit-impaired or an actual default occurs.

AG172. For loan commitments, an entity considers changes in the risk of a default occurring on the loan to which a loan commitment relates. For financial guarantee contracts, an entity considers the changes in the risk that the specified debtor will default on the contract.

AG173. The significance of a change in the credit risk since initial recognition depends on the risk of a default occurring as at initial recognition. Thus, a given change, in absolute terms, in the risk of a default occurring will be more significant for a financial instrument with a lower initial risk of a default occurring compared to a financial instrument with a higher initial risk of a default occurring.

AG174. The risk of a default occurring on financial instruments that have comparable credit risk is higher the longer the expected life of the instrument; for example, the risk of a default occurring on an AAA-rated bond with an expected life of 10 years is higher than that on an AAA-rated bond with an expected life of five years.

AG175. Because of the relationship between the expected life and the risk of a default occurring, the change in credit risk cannot be assessed simply by comparing the change in the absolute risk of a default occurring over time. For example, if the risk of a default occurring for a financial instrument with an expected life of 10 years at initial recognition is identical to the risk of a default occurring on that financial instrument when its expected life in a subsequent period is only five years, that may indicate an increase in credit risk. This is because the risk of a default occurring over the expected life usually decreases as time passes if the credit risk is unchanged and the financial instrument is closer to maturity. However, for financial instruments that only have significant payment obligations close to the maturity of the financial instrument the risk of a default occurring may not necessarily decrease as time passes. In such a case, an entity should also consider other qualitative factors that would demonstrate whether credit risk has increased significantly since initial recognition.

AG176. An entity may apply various approaches when assessing whether the credit risk on a financial instrument has increased significantly since initial recognition or when measuring expected credit losses. An entity may apply different approaches for different financial instruments. An approach that does not include an explicit probability of default as an input per se, such as a credit loss rate approach, can be consistent with the requirements in this Standard, provided that an entity is able to separate the changes in the risk of a default occurring from changes in other drivers of expected credit losses, such as collateral, and considers the following when making the assessment:

(a) The change in the risk of a default occurring since initial recognition;

(b) The expected life of the financial instrument; and

(c) Reasonable and supportable information that is available without undue cost or effort that may affect credit risk.

AG177. The methods used to determine whether credit risk has increased significantly on a financial instrument since initial recognition should consider the characteristics of the financial instrument (or group of financial instruments) and the default patterns in the past for comparable financial instruments. Despite the requirement in paragraph 81, for financial instruments for which default patterns are not concentrated at a specific point during the expected life of the financial instrument, changes in the risk of a default occurring over the next 12 months may be a reasonable approximation of the changes in the lifetime risk of a default occurring. In such cases, an entity may use changes in the risk of a default occurring over the next 12 months to determine whether credit risk has increased significantly since initial recognition, unless circumstances indicate that a lifetime assessment is necessary.

AG178. However, for some financial instruments, or in some circumstances, it may not be appropriate to use changes in the risk of a default occurring over the next 12 months to determine whether lifetime expected credit losses should be recognised. For example, the change in the risk of a default occurring in the next 12 months may not be a suitable basis for determining whether credit risk has increased on a financial instrument with a maturity of more than 12 months when:

(a) The financial instrument only has significant payment obligations beyond the next 12 months;

(b) Changes in relevant macroeconomic or other credit-related factors occur that are not adequately reflected in the risk of a default occurring in the next 12 months; or

(c) Changes in credit-related factors only have an impact on the credit risk of the financial instrument (or have a more pronounced effect) beyond 12 months.

Determining Whether Credit Risk has Increased Significantly since Initial Recognition

AG179. When determining whether the recognition of lifetime expected credit losses is required, an entity shall consider reasonable and supportable information that is available without undue cost or effort and that may affect the credit risk on a financial instrument in accordance with paragraph 90(c). An entity need not undertake an exhaustive search for information when determining whether credit risk has increased significantly since initial recognition.

AG180. Credit risk analysis is a multifactor and holistic analysis; whether a specific factor is relevant, and its weight compared to other factors, will depend on the type of product, characteristics of the financial instruments and the borrower as well as the geographical region. An entity shall consider reasonable and supportable information that is available without undue cost or effort and that is relevant for the particular financial instrument being assessed. However, some factors or indicators may not be identifiable on an individual financial instrument level. In such a case, the factors or indicators should be assessed for appropriate portfolios, groups of portfolios or portions of a portfolio of financial instruments to determine whether the requirement in paragraph 75 for the recognition of lifetime expected credit losses has been met.

AG181. The following non-exhaustive list of information may be relevant in assessing changes in credit risk:

(a) Significant changes in internal price indicators of credit risk as a result of a change in credit risk since inception, including, but not limited to, the credit spread that would result if a particular financial instrument or similar financial instrument with the same terms and the same counterparty were newly originated or issued at the reporting date.

(b) Other changes in the rates or terms of an existing financial instrument that would be significantly different if the instrument was newly originated or issued at the reporting date (such as more stringent covenants, increased amounts of collateral or guarantees, or higher revenue coverage) because of changes in the credit risk of the financial instrument since initial recognition.

(c) Significant changes in external market indicators of credit risk for a particular financial instrument or similar financial instruments with the same expected life. Changes in market indicators of credit risk include, but are not limited to:

(i) The credit spread;

(ii) The credit default swap prices for the borrower;

(iii) The length of time or the extent to which the fair value of a financial asset has been less than its amortised cost; and

(iv) Other market information related to the borrower, such as changes in the price of a borrower's debt and equity instruments.

(d) An actual or expected significant change in the financial instrument's external credit rating.

(e) An actual or expected internal credit rating downgrade for the borrower or decrease in behavioural scoring used to assess credit risk internally. Internal credit ratings and internal behavioural scoring are more reliable when they are mapped to external ratings or supported by default studies.

(f) Existing or forecast adverse changes in business, financial or economic conditions that are expected to cause a significant change in the borrower's ability to meet its debt obligations, such as an actual or expected increase in interest rates or an actual or expected significant increase in unemployment rates.

(g) An actual or expected significant change in the operating results of the borrower. Examples include actual or expected declining revenues or margins, increasing operating risks, working capital deficiencies, decreasing asset quality, increased balance sheet leverage, liquidity, management problems or changes in the scope of operation or organisational structure (such as the discontinuance of a segment of the entity) that results in a significant change in the borrower's ability to meet its debt obligations.

(h) Significant increases in credit risk on other financial instruments of the same borrower.

(i) An actual or expected significant adverse change in the regulatory, economic, or technological environment of the borrower that results in a significant change in the borrower's ability to meet its debt obligations, such as a decline in the demand for the borrower's sales product because of a shift in technology.

(j) Significant changes in the value of the collateral supporting the obligation or in the quality of third-party guarantees or credit enhancements, which are expected to reduce the borrower's economic incentive to make scheduled contractual payments or to otherwise have an effect on the probability of a default occurring. For example, if the value of collateral declines because house prices decline, borrowers in some jurisdictions have a greater incentive to default on their mortgages.

(k) A significant change in the quality of the guarantee provided by an entity's owners (or an individual's guarantors) if the entity's owners (or guarantors) have an incentive and financial ability to prevent default by capital or cash infusion.

(l) Significant changes, such as reductions in financial support from a controlling entity or other affiliate or an actual or expected significant change in the quality of credit enhancement, that are expected to reduce the borrower's economic incentive to make scheduled contractual payments. Credit quality enhancements or support include the consideration of the financial condition of the guarantor and/or, for interests issued in securitisations, whether subordinated interests are expected to be capable of absorbing expected credit losses (for example, on the loans underlying the security).

(m) Expected changes in the loan documentation including an expected breach of contract that may lead to covenant waivers or amendments, interest payment holidays, interest rate step-ups, requiring additional collateral or guarantees, or other changes to the contractual framework of the instrument.

(n) Significant changes in the expected performance and behaviour of the borrower, including changes in the payment status of borrowers in the economic entity (for example, an increase in the expected number or extent of delayed contractual payments).

(o) Changes in the entity's credit management approach in relation to the financial instrument; i.e., based on emerging indicators of changes in the credit risk of the financial instrument, the entity's credit risk management practice is expected to become more active or to be focused on managing the instrument, including the instrument becoming more closely monitored or controlled, or the entity specifically intervening with the borrower.

(p) Past due information, including the rebuttable presumption as set out in paragraph 83.

AG182. In some cases, the qualitative and non-statistical quantitative information available may be sufficient to determine that a financial instrument has met the criterion for the recognition of a loss allowance at an amount equal to lifetime expected credit losses. That is, the information does not need to flow through a statistical model or credit ratings process in order to determine whether there has been a significant increase in the credit risk of the financial instrument. In other cases, an entity may need to consider other information, including information from its statistical models or credit ratings processes. Alternatively, the entity may base the assessment on both types of information, i.e., qualitative factors that are not captured through the internal ratings process and a specific internal rating category at the reporting date, taking into consideration the credit risk characteristics at initial recognition, if both types of information are relevant.

More than 30 Days Past Due Rebuttable Presumption

AG183. The rebuttable presumption in paragraph 83 is not an absolute indicator that lifetime expected credit losses should be recognised, but is presumed to be the latest point at which lifetime expected credit losses should be recognised even when using forward-looking information (including macroeconomic factors on a portfolio level).

AG184. An entity can rebut this presumption. However, it can do so only when it has reasonable and supportable information available that demonstrates that even if contractual payments become more than 30 days past due, this does not represent a significant increase in the credit risk of a financial instrument. For example when non-payment was an administrative oversight, instead of resulting from financial difficulty of the borrower, or the entity has access to historical evidence that demonstrates that there is no correlation between significant increases in the risk of a default occurring and financial assets on which payments are more than 30 days past due, but that evidence does identify such a correlation when payments are more than 60 days past due.

AG185. An entity cannot align the timing of significant increases in credit risk and the recognition of lifetime expected credit losses to when a financial asset is regarded as credit-impaired or an entity's internal definition of default.

Financial Instruments that have Low Credit Risk at the Reporting Date

AG186. The credit risk on a financial instrument is considered low for the purposes of paragraph 82, if the financial instrument has a low risk of default, the borrower has a strong capacity to meet its contractual cash flow obligations in the near term and adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil its contractual cash flow obligations. Financial instruments are not considered to have low credit risk when they are regarded as having a low risk of loss simply because of the value of collateral and the financial instrument without that collateral would not be considered low credit risk. Financial instruments are also not considered to have low credit risk simply because they have a lower risk of default than the entity's other financial instruments or relative to the credit risk of the jurisdiction within which an entity operates.

AG187. To determine whether a financial instrument has low credit risk, an entity may use its internal credit risk ratings or other methodologies that are consistent with a globally understood definition of low credit risk and that consider the risks and the type of financial instruments that are being assessed. An external rating of 'investment grade' is an example of a financial instrument that may be considered as having low credit risk. However, financial instruments are not required to be externally rated to be considered to have low credit risk. They should, however, be considered to have low credit risk from a market participant perspective taking into account all of the terms and conditions of the financial instrument.

AG188. Lifetime expected credit losses are not recognised on a financial instrument simply because it was considered to have low credit risk in the previous reporting period and is not considered to have low credit risk at the reporting date. In such a case, an entity shall determine whether there has been a significant increase in credit risk since initial recognition and thus whether lifetime expected credit losses are required to be recognised in accordance with paragraph 75.

Modifications

AG189. In some circumstances, the renegotiation or modification of the contractual cash flows of a financial asset can lead to the derecognition of the existing financial asset in accordance with this Standard. When the modification of a financial asset results in the derecognition of the existing financial asset and the subsequent recognition of the modified financial asset, the modified asset is considered a 'new' financial asset for the purposes of this Standard.

AG190. Accordingly the date of the modification shall be treated as the date of initial recognition of that financial asset when applying the impairment requirements to the modified financial asset. This typically means measuring the loss allowance at an amount equal to 12-month expected credit losses until the requirements for the recognition of lifetime expected credit losses in paragraph 75 are met. However, in some unusual circumstances following a modification that results in derecognition of the original financial asset, there may be evidence that the modified financial asset is credit-impaired at initial recognition, and thus, the financial asset should be recognised as an originated credit-impaired financial asset. This might occur, for example, in a situation in which there was a substantial modification of a distressed asset that resulted in the derecognition of the original financial asset. In such a case, it may be possible for the modification to result in a new financial asset which is credit-impaired at initial recognition.

AG191. If the contractual cash flows on a financial asset have been renegotiated or otherwise modified, but the financial asset is not derecognised, that financial asset is not automatically considered to have lower credit risk. An entity shall assess whether there has been a significant increase in credit risk since initial recognition on the basis of all reasonable and supportable information that is available without undue cost or effort. This includes historical and forward-looking information and an assessment of the credit risk over the expected life of the financial asset, which includes information about the circumstances that led to the modification. Evidence that the criteria for the recognition of lifetime expected credit losses are no longer met may include a history of up-to-date and timely payment performance against the modified contractual terms. Typically a borrower would need to demonstrate consistently good payment behaviour over a period of time before the credit risk is considered to have decreased. For example, a history of missed or incomplete payments would not typically be erased by simply making one payment on time following a modification of the contractual terms.

Measurement of Expected Credit Losses

Expected Credit Losses

AG192. Expected credit losses are a probability-weighted estimate of credit losses (i.e., the present value of all cash shortfalls) over the expected life of the financial instrument. A cash shortfall is the difference between the cash flows that are due to an entity in accordance with the contract and the cash flows that the entity expects to receive. Because expected credit losses consider the amount and timing of payments, a credit loss arises even if the entity expects to be paid in full but later than when contractually due.

AG193. For financial assets, a credit loss is the present value of the difference between:

(a) The contractual cash flows that are due to an entity under the contract; and

(b) The cash flows that the entity expects to receive.

AG194. For undrawn loan commitments, a credit loss is the present value of the difference between:

(a) The contractual cash flows that are due to the entity if the holder of the loan commitment draws down the loan; and

(b) The cash flows that the entity expects to receive if the loan is drawn down.

AG195. An entity's estimate of expected credit losses on loan commitments shall be consistent with its expectations of drawdowns on that loan commitment, i.e., it shall consider the expected portion of the loan commitment that will be drawn down within 12 months of the reporting date when estimating 12-month expected credit losses, and the expected portion of the loan commitment that will be drawn down over the expected life of the loan commitment when estimating lifetime expected credit losses.

AG196. For a financial guarantee contract, the entity is required to make payments only in the event of a default by the debtor in accordance with the terms of the instrument that is guaranteed. Accordingly, cash shortfalls are the expected payments to reimburse the holder for a credit loss that it incurs less any amounts that the entity expects to receive from the holder, the debtor or any other party. If the asset is fully guaranteed, the estimation of cash shortfalls for a financial guarantee contract would be consistent with the estimations of cash shortfalls for the asset subject to the guarantee.

AG197. For a financial asset that is credit-impaired at the reporting date, but that is not a purchased or originated credit-impaired financial asset, an entity shall measure the expected credit losses as the difference between the asset's gross carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. Any adjustment is recognised in surplus or deficit as an impairment gain or loss.

AG198. When measuring a loss allowance for a lease receivable, the cash flows used for determining the expected credit losses should be consistent with the cash flows used in measuring the lease receivable in accordance with PBE IPSAS 13 *Leases*.

AG199. An entity may use practical expedients when measuring expected credit losses if they are consistent with the principles in paragraph 90. An example of a practical expedient is the calculation of the expected credit losses on receivables using a provision matrix. The entity would use its historical credit loss experience (adjusted as appropriate in accordance with paragraphs AG215–AG216) for receivables to estimate the 12-month expected credit losses or the lifetime expected credit losses on the financial assets as relevant. A provision matrix might, for example, specify fixed provision rates depending on the number of days that a trade receivable is past due (for example, 1 per cent if not past due, 2 per cent if less than 30 days past due, 3 per cent if more than 30 days but less than 90 days past due, 20 per cent if 90–180 days past due etc). Depending on the diversity of its customer base, the entity would use appropriate groupings if its historical credit loss experience shows significantly different loss patterns for different customer segments. Examples of criteria that might be used to group assets include geographical region, product type, customer rating, collateral or trade credit insurance and type of customer (such as other government entities or individuals).

Definition of Default

AG200. Paragraph 81 requires that when determining whether the credit risk on a financial instrument has increased significantly, an entity shall consider the change in the risk of a default occurring since initial recognition.

AG201. When defining default for the purposes of determining the risk of a default occurring, an entity shall apply a default definition that is consistent with the definition used for internal credit risk management purposes for the relevant financial instrument and consider qualitative indicators (for example, financial covenants) when appropriate. However, there is a rebuttable presumption that default does not occur later than when a financial asset is 90 days past due unless an entity has reasonable and supportable information to demonstrate that a more lagging default criterion is more appropriate. The definition of default used for these purposes shall be applied consistently to all financial instruments unless information becomes available that demonstrates that another default definition is more appropriate for a particular financial instrument.

Period over Which to Estimate Expected Credit Losses

AG202. In accordance with paragraph 92, the maximum period over which expected credit losses shall be measured is the maximum contractual period over which the entity is exposed to credit risk. For loan commitments and financial guarantee contracts, this is the maximum contractual period over which an entity has a present contractual obligation to extend credit.

AG203. However, in accordance with paragraph 93, some financial instruments include both a loan and an undrawn commitment component and the entity's contractual ability to demand repayment and cancel the undrawn commitment does not limit the entity's exposure to credit losses to the contractual notice period. For example, revolving credit facilities, such as line of credit provided by a government owned bank, can be contractually withdrawn by the lender with as little as one day's notice. However, in practice lenders continue to extend credit for a longer period and may only withdraw the facility after the credit risk of the borrower increases, which could be too late to prevent some or all of the expected credit losses. These financial instruments generally have the following characteristics as a result of the nature of the financial instrument, the way in which the financial instruments are managed, and the nature of the available information about significant increases in credit risk:

(a) The financial instruments do not have a fixed term or repayment structure and usually have a short contractual cancellation period (for example, one day);

(b) The contractual ability to cancel the contract is not enforced in the normal day-to-day management of the financial instrument and the contract may only be cancelled when the entity becomes aware of an increase in credit risk at the facility level; and

(c) The financial instruments are managed on a collective basis.

AG204. When determining the period over which the entity is expected to be exposed to credit risk, but for which expected credit losses would not be mitigated by the entity's normal credit risk management actions, an entity should consider factors such as historical information and experience about:

(a) The period over which the entity was exposed to credit risk on similar financial instruments;

(b) The length of time for related defaults to occur on similar financial instruments following a significant increase in credit risk; and

(c) The credit risk management actions that an entity expects to take once the credit risk on the financial instrument has increased, such as the reduction or removal of undrawn limits.

Probability-weighted Outcome

AG205. The purpose of estimating expected credit losses is neither to estimate a worst-case scenario nor to estimate the best-case scenario. Instead, an estimate of expected credit losses shall always reflect the possibility that a credit loss occurs and the possibility that no credit loss occurs even if the most likely outcome is no credit loss.

AG206. Paragraph 90(a) requires the estimate of expected credit losses to reflect an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes. In practice, this may not need to be a complex analysis. In some cases, relatively simple modelling may be sufficient, without the need for a large number of detailed simulations of scenarios. For example, the average credit losses of a large group of financial instruments with shared risk characteristics may be a reasonable estimate of the probability-weighted amount. In other situations, the identification of scenarios that specify the amount and timing of the cash flows for particular outcomes and the estimated probability of those outcomes will probably be needed. In those situations, the expected credit losses shall reflect at least two outcomes in accordance with paragraph 91.

AG207. For lifetime expected credit losses, an entity shall estimate the risk of a default occurring on the financial instrument during its expected life. 12-month expected credit losses are a portion of the lifetime expected credit losses and represent the lifetime cash shortfalls that will result if a default occurs in the 12 months after the reporting date (or a shorter period if the expected life of a financial instrument is less than 12 months), weighted by the probability of that default occurring. Thus, 12-month expected credit losses are neither the lifetime expected credit losses that an entity will incur on financial instruments that it predicts will default in the next 12 months nor the cash shortfalls that are predicted over the next 12 months.

Time Value of Money

AG208. Expected credit losses shall be discounted to the reporting date, not to the expected default or some other date, using the effective interest rate determined at initial recognition or an approximation thereof. If a financial instrument has a variable interest rate, expected credit losses shall be discounted using the current effective interest rate determined in accordance with paragraph AG160.

AG209. For purchased or originated credit-impaired financial assets, expected credit losses shall be discounted using the credit-adjusted effective interest rate determined at initial recognition.

AG210. Expected credit losses on lease receivables shall be discounted using the same discount rate used in the measurement of the lease receivable in accordance with PBE IPSAS 13.

AG211. The expected credit losses on a loan commitment shall be discounted using the effective interest rate, or an approximation thereof, that will be applied when recognising the financial asset resulting from the loan commitment. This is because for the purpose of applying the impairment requirements, a financial asset that is recognised following a draw down on a loan commitment shall be treated as a continuation of that commitment instead of as a new financial instrument. The expected credit losses on the financial asset shall therefore be measured considering the initial credit risk of the loan commitment from the date that the entity became a party to the irrevocable commitment.

AG212. Expected credit losses on financial guarantee contracts or on loan commitments for which the effective interest rate cannot be determined shall be discounted by applying a discount rate that reflects the current market assessment of the time value of money and the risks that are specific to the cash flows but only if, and to the extent that, the risks are taken into account by adjusting the discount rate instead of adjusting the cash shortfalls being discounted.

Reasonable and Supportable Information

AG213. For the purpose of this Standard, reasonable and supportable information is that which is reasonably available at the reporting date without undue cost or effort, including information about past events, current conditions and forecasts of future economic conditions. Information that is available for financial reporting purposes is considered to be available without undue cost or effort.

AG214. An entity is not required to incorporate forecasts of future conditions over the entire expected life of a financial instrument. The degree of judgement that is required to estimate expected credit losses depends on the availability of detailed information. As the forecast horizon increases, the availability of detailed information decreases and the degree of judgement required to estimate expected credit losses increases. The estimate of expected credit losses does not require a detailed estimate for periods that are far in the future—for such periods, an entity may extrapolate projections from available, detailed information.

AG215. An entity need not undertake an exhaustive search for information but shall consider all reasonable and supportable information that is available without undue cost or effort and that is relevant to the estimate of expected credit losses, including the effect of expected prepayments. The information used shall include factors that are specific to the borrower, general economic conditions and an assessment of both the current as well as the forecast direction of conditions at the reporting date. An entity may use various sources of data, that may be both internal (entity-specific) and external. Possible data sources include internal historical credit loss experience, internal ratings, credit loss experience of other entities and external ratings, reports and statistics. Entities that have no, or insufficient, sources of entity-specific data may use peer group experience for the comparable financial instrument (or groups of financial instruments).

AG216. Historical information is an important anchor or base from which to measure expected credit losses. However, an entity shall adjust historical data, such as credit loss experience, on the basis of current observable data to reflect the effects of the current conditions and its forecasts of future conditions that did not affect the period on which the historical data is based, and to remove the effects of the conditions in the historical period that are not relevant to the future contractual cash flows. In some cases, the best reasonable and supportable information could be the unadjusted historical information, depending on the nature of the historical information and when it was calculated, compared to circumstances at the reporting date and the characteristics of the financial instrument being considered. Estimates of changes in expected credit losses should reflect, and be directionally consistent with, changes in related observable data from period to period (such as changes in unemployment rates, property prices, commodity prices, payment status or other factors that are indicative of credit losses on the financial instrument or in the group of financial instruments and in the magnitude of those changes). An entity shall regularly review the methodology and assumptions used for estimating expected credit losses to reduce any differences between estimates and actual credit loss experience.

AG217. When using historical credit loss experience in estimating expected credit losses, it is important that information about historical credit loss rates is applied to groups that are defined in a manner that is consistent with the groups for which the historical credit loss rates were observed. Consequently, the method used shall enable each group of financial assets to be associated with information about past credit loss experience in groups of financial assets with similar risk characteristics and with relevant observable data that reflects current conditions.

AG218. Expected credit losses reflect an entity's own expectations of credit losses. However, when considering all reasonable and supportable information that is available without undue cost or effort in estimating expected credit losses, an entity should also consider observable market information about the credit risk of the particular financial instrument or similar financial instruments.

Collateral

AG219. For the purposes of measuring expected credit losses, the estimate of expected cash shortfalls shall reflect the cash flows expected from collateral and other credit enhancements that are part of the contractual terms and are not recognised separately by the entity. The estimate of expected cash shortfalls on a collateralised financial instrument reflects the amount and timing of cash flows that are expected from foreclosure on the collateral less the costs of obtaining and selling the collateral, irrespective of whether foreclosure is probable (i.e., the estimate of expected cash flows considers the probability of a foreclosure and the cash flows that would result from it). Consequently, any cash flows that are expected from the realisation of the collateral beyond the contractual maturity of the contract should be included in this analysis. Any collateral obtained as a result of foreclosure is not recognised as an asset that is separate from the collateralised financial instrument unless it meets the relevant recognition criteria for an asset in this or other Standards.

Reclassification of Financial Assets

AG220. If an entity reclassifies financial assets in accordance with paragraph 54, paragraph 94 requires that the reclassification is applied prospectively from the reclassification date. Both the amortised cost measurement category and the fair value through other comprehensive revenue and expense measurement category require that the effective interest rate is determined at initial recognition. Both of those measurement categories also require that the impairment requirements are applied in the same way. Consequently, when an entity reclassifies a financial asset between the amortised cost measurement category and the fair value through other comprehensive revenue and expense measurement category:

(a) The recognition of interest revenue will not change and therefore the entity continues to use the same effective interest rate.

(b) The measurement of expected credit losses will not change because both measurement categories apply the same impairment approach. However if a financial asset is reclassified out of the fair value through other comprehensive revenue and expense measurement category and into the amortised cost measurement category, a loss allowance would be recognised as an adjustment to the gross carrying amount of the financial asset from the reclassification date. If a financial asset is reclassified out of the amortised cost measurement category and into the fair value through other comprehensive revenue and expense measurement category, the loss allowance would be derecognised (and thus would no longer be recognised as an adjustment to the gross carrying amount) but instead would be recognised as an accumulated impairment amount (of an equal amount) in other comprehensive revenue and expense and would be disclosed from the reclassification date.

AG221. However, an entity is not required to separately recognise interest revenue or impairment gains or losses for a financial asset measured at fair value through surplus or deficit. Consequently, when an entity reclassifies a financial asset out of the fair value through surplus or deficit measurement category, the effective interest rate is determined on the basis of the fair value of the asset at the reclassification date. In addition, for the purposes of applying paragraphs 73–93 to the financial asset from the reclassification date, the date of the reclassification is treated as the date of initial recognition.

Gains and Losses

AG222. Paragraph 106 permits an entity to make an irrevocable election to present in other comprehensive revenue and expense changes in the fair value of an investment in an equity instrument that is not held for trading. This election is made on an instrument-by-instrument (i.e., share-by-share) basis. Amounts presented in other comprehensive revenue and expense shall not be subsequently transferred to surplus or deficit. However, the entity may transfer the cumulative gain or loss within net assets/equity. Dividends or similar distributions on such investments are recognised in surplus or deficit in accordance with paragraph 107 unless the dividend clearly represents a recovery of part of the cost of the investment.

AG223. Unless paragraph 44 applies, paragraph 41 requires that a financial asset is measured at fair value through other comprehensive revenue and expense if the contractual terms of the financial asset give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding and the asset is held in a management model whose objective is achieved by both collecting contractual cash flows and selling financial assets. This measurement category recognises information in surplus or deficit as if the financial asset is measured at amortised cost, while the financial asset is measured in the statement of financial position at fair value. Gains or losses, other than those that are recognised in surplus or deficit in accordance with paragraphs 111–112, are recognised in other comprehensive revenue and expense. When these financial assets are derecognised, cumulative gains or losses previously recognised in other comprehensive revenue and expense are reclassified to surplus or deficit.

This reflects the gain or loss that would have been recognised in surplus or deficit upon derecognition if the financial asset had been measured at amortised cost.

AG224. An entity applies PBE IPSAS 4 to financial assets and financial liabilities that are monetary items in accordance with PBE IPSAS 4 and denominated in a foreign currency. PBE IPSAS 4 requires any foreign exchange gains and losses on monetary assets and monetary liabilities to be recognised in surplus or deficit. An exception is a monetary item that is designated as a hedging instrument in a cash flow hedge (see paragraph 140), a hedge of a net investment (see paragraph 142) or a fair value hedge of an equity instrument for which an entity has elected to present changes in fair value in other comprehensive revenue and expense in accordance with paragraph 106 (see paragraph 137).

AG225. For the purpose of recognising foreign exchange gains and losses under PBE IPSAS 4, a financial asset measured at fair value through other comprehensive revenue and expense in accordance with paragraph 41 is treated as a monetary item. Accordingly, such a financial asset is treated as an asset measured at amortised cost in the foreign currency. Exchange differences on the amortised cost are recognised in surplus or deficit and other changes in the carrying amount are recognised in accordance with paragraph 111.

AG226. Paragraph 106 permits an entity to make an irrevocable election to present in other comprehensive revenue and expense subsequent changes in the fair value of particular investments in equity instruments. Such an investment is not a monetary item. Accordingly, the gain or loss that is presented in other comprehensive revenue and expense in accordance with paragraph 106 includes any related foreign exchange component.

AG227. If there is a hedging relationship between a non-derivative monetary asset and a non-derivative monetary liability, changes in the foreign currency component of those financial instruments are presented in surplus or deficit.

Liabilities Designated as at Fair Value Through Surplus or Deficit

AG228. When an entity designates a financial liability as at fair value through surplus or deficit, it must determine whether presenting in other comprehensive revenue and expense the effects of changes in the liability's credit risk would create or enlarge an accounting mismatch in surplus or deficit. An accounting mismatch would be created or enlarged if presenting the effects of changes in the liability's credit risk in other comprehensive revenue and expense would result in a greater mismatch in surplus or deficit than if those amounts were presented in surplus or deficit.

AG229. To make that determination, an entity must assess whether it expects that the effects of changes in the liability's credit risk will be offset in surplus or deficit by a change in the fair value of another financial instrument measured at fair value through surplus or deficit. Such an expectation must be based on an economic relationship between the characteristics of the liability and the characteristics of the other financial instrument.

AG230. That determination is made at initial recognition and is not reassessed. For practical purposes the entity need not enter into all of the assets and liabilities giving rise to an accounting mismatch at exactly the same time. A reasonable delay is permitted provided that any remaining transactions are expected to occur. An entity must apply consistently its methodology for determining whether presenting in other comprehensive revenue and expense the effects of changes in the liability's credit risk would create or enlarge an accounting mismatch in surplus or deficit. However, an entity may use different methodologies when there are different economic relationships between the characteristics of the liabilities designated as at fair value through surplus or deficit and the characteristics of the other financial instruments. PBE IPSAS 30 *Financial Instruments: Disclosures* requires an entity to provide qualitative disclosures in the notes to the financial statements about its methodology for making that determination.

AG231. If such a mismatch would be created or enlarged, the entity is required to present all changes in fair value (including the effects of changes in the credit risk of the liability) in surplus or deficit. If such a mismatch would not be created or enlarged, the entity is required to present the effects of changes in the liability's credit risk in other comprehensive revenue and expense.

AG232. Amounts presented in other comprehensive revenue and expense shall not be subsequently transferred to surplus or deficit. However, the entity may transfer the cumulative gain or loss within net assets/equity.

AG233. The following example describes a situation in which an accounting mismatch would be created in surplus or deficit if the effects of changes in the credit risk of the liability were presented in other comprehensive revenue and expense. A Mortgage and Housing Corporation provides loans to customers and funds those loans by selling bonds with matching characteristics (e.g., amount outstanding, repayment profile, term and currency) in the market. The contractual terms of the loan permit the mortgage customer to prepay its loan (i.e., satisfy its obligation to the bank) by buying the corresponding bond at fair value in the market and delivering that bond to the Mortgage and Housing Corporation. As a result of that contractual prepayment right, if the credit quality of the bond worsens (and, thus, the fair value of the Mortgage and Housing Corporation's liability decreases), the fair value of the Mortgage and Housing Corporation's loan asset also decreases. The change in the fair value of the asset reflects the mortgage customer's contractual right to prepay the mortgage loan by buying the underlying bond at fair value (which, in this example, has decreased) and delivering the bond to the Mortgage and Housing Corporation. Consequently, the effects of changes in the credit risk of the liability (the bond) will be offset in surplus or deficit by a corresponding change in the fair value of a financial asset (the loan). If the effects of changes in the liability's credit risk were presented in other comprehensive revenue and expense there would be an accounting mismatch in surplus or deficit. Consequently, the Mortgage and Housing Corporation is required to present all changes in fair value of the liability (including the effects of changes in the liability's credit risk) in surplus or deficit.

AG234. In the example in paragraph AG233, there is a contractual linkage between the effects of changes in the credit risk of the liability and changes in the fair value of the financial asset (i.e., as a result of the mortgage customer's contractual right to prepay the loan by buying the bond at fair value and delivering the bond to the Mortgage and Housing Corporation). However, an accounting mismatch may also occur in the absence of a contractual linkage.

AG235. For the purposes of applying the requirements in paragraphs 108 and 109, an accounting mismatch is not caused solely by the measurement method that an entity uses to determine the effects of changes in a liability's credit risk. An accounting mismatch in surplus or deficit would arise only when the effects of changes in the liability's credit risk (as defined in PBE IPSAS 30) are expected to be offset by changes in the fair value of another financial instrument. A mismatch that arises solely as a result of the measurement method (i.e., because an entity does not isolate changes in a liability's credit risk from some other changes in its fair value) does not affect the determination required by paragraphs 108 and 109. For example, an entity may not isolate changes in a liability's credit risk from changes in liquidity risk. If the entity presents the combined effect of both factors in other comprehensive revenue and expense, a mismatch may occur because changes in liquidity risk may be included in the fair value measurement of the entity's financial assets and the entire fair value change of those assets is presented in surplus or deficit. However, such a mismatch is caused by measurement imprecision, not the offsetting relationship described in paragraph AG229 and, therefore, does not affect the determination required by paragraphs 108 and 109.

The Meaning of 'Credit Risk' (paragraphs 108 and 109)

AG236. PBE IPSAS 30 defines credit risk as 'the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation'. The requirement in paragraph 108(a) relates to the risk that the issuer will fail to perform on that particular liability. It does not necessarily relate to the creditworthiness of the issuer. For example, if an entity issues a collateralised liability and a non-collateralised liability that are otherwise identical, the credit risk of those two liabilities will be different, even though they are issued by the same entity. The credit risk on the collateralised liability will be less than the credit risk of the non-collateralised liability. The credit risk for a collateralised liability may be close to zero.

AG237. For the purposes of applying the requirement in paragraph 108(a), credit risk is different from asset-specific performance risk. Asset-specific performance risk is not related to the risk that an entity will fail to discharge a particular obligation but instead it is related to the risk that a single asset or a group of assets will perform poorly (or not at all).

AG238. The following are examples of asset-specific performance risk:

(a) A liability with a unit-linking feature whereby the amount due to investors is contractually determined on the basis of the performance of specified assets. The effect of that unit-linking feature on the fair value of the liability is asset-specific performance risk, not credit risk.

(b) A liability issued by a structured entity with the following characteristics. The entity is legally isolated so the assets in the entity are ring-fenced solely for the benefit of its investors, even in the event of bankruptcy. The entity enters into no other transactions and the assets in the entity cannot be hypothecated. Amounts are due to the entity's investors only if the ring-fenced assets generate cash flows. Thus, changes in the fair value of the liability primarily reflect changes in the fair value of the assets. The effect of the performance of the assets on the fair value of the liability is asset-specific performance risk, not credit risk.

Determining the Effects of Changes in Credit Risk

AG239. For the purposes of applying the requirement in paragraph 108(a), an entity shall determine the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability either:

(a) As the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk (see paragraphs AG240 and AG241); or

(b) Using an alternative method the entity believes more faithfully represents the amount of change in the liability's fair value that is attributable to changes in its credit risk.

AG240. Changes in market conditions that give rise to market risk include changes in a benchmark interest rate, the price of another entity's financial instrument, a commodity price, a foreign exchange rate or an index of prices or rates.

AG241. If the only significant relevant changes in market conditions for a liability are changes in an observed (benchmark) interest rate, the amount in paragraph AG239(a) can be estimated as follows:

(a) First, the entity computes the liability's internal rate of return at the start of the period using the fair value of the liability and the liability's contractual cash flows at the start of the period. It deducts from this rate of return the observed (benchmark) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.

(b) Next, the entity calculates the present value of the cash flows associated with the liability using the liability's contractual cash flows at the end of the period and a discount rate equal to the sum of (i) the observed (benchmark) interest rate at the end of the period and (ii) the instrument-specific component of the internal rate of return as determined in (a).

(c) The difference between the fair value of the liability at the end of the period and the amount determined in (b) is the change in fair value that is not attributable to changes in the observed (benchmark) interest rate. This is the amount to be presented in other comprehensive revenue and expense in accordance with paragraph 108(a).

AG242. The example in paragraph AG241 assumes that changes in fair value arising from factors other than changes in the instrument's credit risk or changes in observed (benchmark) interest rates are not significant. This method would not be appropriate if changes in fair value arising from other factors are significant. In those cases, an entity is required to use an alternative method that more faithfully measures the effects of changes in the liability's credit risk (see paragraph AG239(b)). For example, if the instrument in the example contains an embedded derivative, the change in fair value of the embedded derivative is excluded in determining the amount to be presented in other comprehensive revenue and expense in accordance with paragraph 108(a).

AG243. As with all fair value measurements, an entity's measurement method for determining the portion of the change in the liability's fair value that is attributable to changes in its credit risk must make maximum use of relevant observable inputs and minimum use of unobservable inputs.

Hedge Accounting

Hedging Instruments

Qualifying Instruments

AG244. Derivatives that are embedded in hybrid contracts, but that are not separately accounted for, cannot be designated as separate hedging instruments.

AG245. An entity's own equity instruments are not financial assets or financial liabilities of the entity and therefore cannot be designated as hedging instruments.

AG246. For hedges of foreign currency risk, the foreign currency risk component of a non-derivative financial instrument is determined in accordance with PBE IPSAS 4.

Written Options

AG247. This Standard does not restrict the circumstances in which a derivative that is measured at fair value through surplus or deficit may be designated as a hedging instrument, except for some written options. A written option does not qualify as a hedging instrument unless it is designated as an offset to a purchased option, including one that is embedded in another financial instrument (for example, a written call option used to hedge a callable liability).

Designation of Hedging Instruments

AG248. For hedges other than hedges of foreign currency risk, when an entity designates a non-derivative financial asset or a non-derivative financial liability measured at fair value through surplus or deficit as a hedging instrument, it may only designate the non-derivative financial instrument in its entirety or a proportion of it.

AG249. A single hedging instrument may be designated as a hedging instrument of more than one type of risk, provided that there is a specific designation of the hedging instrument and of the different risk positions as hedged items. Those hedged items can be in different hedging relationships.

Hedged Items

Qualifying Items

AG250. A firm commitment to acquire an operation in a business combination cannot be a hedged item, except for foreign currency risk, because the other risks being hedged cannot be specifically identified and measured. Those other risks are general business risks.

AG251. An equity method investment cannot be a hedged item in a fair value hedge. This is because the equity method recognises in surplus or deficit the investor's share of the investee's surplus or deficit, instead of changes in the investment's fair value. For a similar reason, an investment in a consolidated controlled entity cannot be a hedged item in a fair value hedge. This is because consolidation recognises in surplus or deficit the controlled entity's surplus or deficit, instead of changes in the investment's fair value. A hedge of a net investment in a foreign operation is different because it is a hedge of the foreign currency exposure, not a fair value hedge of the change in the value of the investment.

AG252. Paragraph 125 permits an entity to designate as hedged items aggregated exposures that are a combination of an exposure and a derivative. When designating such a hedged item, an entity assesses whether the aggregated exposure combines an exposure with a derivative so that it creates a different aggregated exposure that is managed as one exposure for a particular risk (or risks). In that case, the entity may designate the hedged item on the basis of the aggregated exposure. For example:

(a) An entity may hedge a given quantity of highly probable oil purchases in 15 months' time against price risk (based on US dollars) using a 15-month futures contract for oil. The highly probable oil purchases and the futures contract for oil in combination can be viewed as a 15-month fixed-amount US dollar foreign currency risk exposure for risk management purposes (i.e., like any fixed-amount US dollar cash outflow in 15 months' time).

(b) An entity may hedge the foreign currency risk for the entire term of a 10-year fixed-rate debt denominated in a foreign currency. However, the entity requires fixed-rate exposure in its functional currency only for a short to medium term (say two years) and floating rate exposure in its functional currency for the remaining term to maturity. At the end of each of the two-year intervals (i.e., on a two-year rolling basis) the entity fixes the next two years' interest rate exposure (if the interest level is such that the entity wants to fix interest rates). In such a situation an entity may enter into a 10-year fixed-to-floating cross-currency interest rate swap that swaps the fixed-rate foreign currency debt into a variable-rate functional currency exposure. This is overlaid with a two-year interest rate swap that—on the basis of the functional currency—swaps variable-rate debt into fixed-rate debt. In effect, the fixed-rate foreign currency debt and the 10-year fixed-to-floating cross-currency interest rate swap in combination are viewed as a 10-year variable-rate debt functional currency exposure for risk management purposes.

AG253. When designating the hedged item on the basis of the aggregated exposure, an entity considers the combined effect of the items that constitute the aggregated exposure for the purpose of assessing hedge effectiveness and measuring hedge ineffectiveness. However, the items that constitute the aggregated exposure remain accounted for separately. This means that, for example:

(a) Derivatives that are part of an aggregated exposure are recognised as separate assets or liabilities measured at fair value; and

(b) If a hedging relationship is designated between the items that constitute the aggregated exposure, the way in which a derivative is included as part of an aggregated exposure must be consistent with the designation of that derivative as the hedging instrument at the level of the aggregated exposure. For example, if an entity excludes the forward element of a derivative from its designation as the hedging instrument for the hedging relationship between the items that constitute the aggregated exposure, it must also exclude the forward element when including that derivative as a hedged item as part of the aggregated exposure. Otherwise, the aggregated exposure shall include a derivative, either in its entirety or a proportion of it.

AG254. Paragraph 127 states that in consolidated financial statements the foreign currency risk of a highly probable forecast transaction within an economic entity may qualify as a hedged item in a cash flow hedge, provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and that the foreign currency risk will affect consolidated surplus or deficit. For this purpose an entity can be a controlling entity, controlled entity, associate, joint arrangement or branch. If the foreign currency risk of a forecast transaction within the economic entity does not affect consolidated surplus or deficit, the transaction cannot qualify as a hedged item. This is usually the case for royalty payments, interest payments or management charges between members of the same economic entity, unless there is a related external transaction. However, when the foreign currency risk of a forecast transaction within an economic entity will affect consolidated surplus or deficit, the transaction within the economic entity can qualify as a hedged item. An example is forecast sales or purchases of inventories between members of the same economic entity if there is an onward sale of the inventory to a party external to the economic entity. Similarly, a forecast sale of plant and equipment within the economic entity from the entity that manufactured it to an entity that will use the plant and equipment in its operations may affect consolidated surplus or deficit. This could occur, for example, because the plant and equipment will be depreciated by the purchasing entity and the amount initially recognised for the plant and equipment may change if the forecast transaction within the economic entity is denominated in a currency other than the functional currency of the purchasing entity.

AG255. If a hedge of a forecast transaction within an economic entity qualifies for hedge accounting, any gain or loss is recognised in, and taken out of, other comprehensive revenue and expense in accordance with paragraph 140. The relevant period or periods during which the foreign currency risk of the hedged transaction affects surplus or deficit is when it affects consolidated surplus or deficit.

Designation of Hedged Items

AG256. A component is a hedged item that is less than the entire item. Consequently, a component reflects only some of the risks of the item of which it is a part or reflects the risks only to some extent (for example, when designating a proportion of an item).

Risk Components

AG257. To be eligible for designation as a hedged item, a risk component must be a separately identifiable component of the financial or the non-financial item, and the changes in the cash flows or the fair value of the item attributable to changes in that risk component must be reliably measurable.

AG258. When identifying what risk components qualify for designation as a hedged item, an entity assesses such risk components within the context of the particular market structure to which the risk or risks relate and in which the hedging activity takes place. Such a determination requires an evaluation of the relevant facts and circumstances, which differ by risk and market.

AG259. When designating risk components as hedged items, an entity considers whether the risk components are explicitly specified in a contract (contractually specified risk components) or whether they are implicit in the fair value or the cash flows of an item of which they are a part (non-contractually specified risk components). Non-contractually specified risk components can relate to items that are not a contract (for example, forecast transactions) or contracts that do not explicitly specify the component (for example, a firm commitment that includes only one single price instead of a pricing formula that references different underlyings). For example:

(a) Entity A has a long-term supply contract for natural gas that is priced using a contractually specified formula that references commodities and other factors (for example, gas oil, fuel oil and other components such as transport charges). Entity A hedges the gas oil component in that supply contract using a gas oil forward contract. Because the gas oil component is specified by the terms and conditions of the supply contract it is a contractually specified risk component. Hence, because of the pricing formula, Entity A concludes that the gas oil price exposure is separately identifiable. At the same time, there is a market for gas oil forward contracts. Hence, Entity A concludes that the gas oil price exposure is reliably measurable. Consequently, the gas oil price exposure in the supply contract is a risk component that is eligible for designation as a hedged item.

(b) Entity B hedges its future coffee purchases based on its production forecast. Hedging starts up to 15 months before delivery for part of the forecast purchase volume. Entity B increases the hedged volume over time (as the delivery date approaches). Entity B uses two different types of contracts to manage its coffee price risk:

(i) Exchange-traded coffee futures contracts; and

(ii) Coffee supply contracts for Arabica coffee from Colombia delivered to a specific manufacturing site. These contracts price a tonne of coffee based on the exchange-traded coffee futures contract price plus a fixed price differential plus a variable logistics services charge using a pricing formula. The coffee supply contract is an executory contract in accordance with which Entity B takes actual delivery of coffee.

For deliveries that relate to the current harvest, entering into the coffee supply contracts allows Entity B to fix the price differential between the actual coffee quality purchased (Arabica coffee from Colombia) and the benchmark quality that is the underlying of the exchange-traded futures contract. However, for deliveries that relate to the next harvest, the coffee supply contracts are not yet available, so the price differential cannot be fixed. Entity B uses exchange-traded coffee futures contracts to hedge the benchmark quality component of its coffee price risk for deliveries that relate to the current harvest as well as the next harvest. Entity B determines that it is exposed to three different risks: coffee price risk reflecting the benchmark quality, coffee price risk reflecting the difference (spread) between the price for the benchmark quality coffee and the particular Arabica coffee from Colombia that it actually receives, and the variable logistics costs. For deliveries related to the current harvest, after Entity B enters into a coffee supply contract, the coffee price risk reflecting the benchmark quality is a contractually specified risk component because the pricing formula includes an indexation to the exchange-traded coffee futures contract price. Entity B concludes that this risk component is separately identifiable and reliably measurable. For deliveries related to the next harvest, Entity B has not yet entered into any coffee supply contracts (i.e., those deliveries are forecast transactions). Hence, the coffee price risk reflecting the benchmark quality is a non-contractually specified risk component. Entity B's analysis of the market structure takes into account how eventual deliveries of the particular coffee that it receives are priced. Hence, on the basis of this analysis of the market structure, Entity B concludes that the forecast transactions also involve the coffee price risk that reflects the benchmark quality as a risk component that is separately identifiable and reliably measurable even though it is not contractually specified. Consequently, Entity B may designate hedging relationships on a risk components basis (for the coffee price risk that reflects the benchmark quality) for coffee supply contracts as well as forecast transactions.

(c) Entity C hedges part of its future jet fuel purchases on the basis of its consumption forecast up to 24 months before delivery and increases the volume that it hedges over time. Entity C hedges this exposure using different types of contracts depending on the time horizon of the hedge, which affects the market liquidity of the derivatives. For the longer time horizons (12–24 months) Entity C uses crude oil contracts because only these have sufficient market liquidity. For time horizons of 6–12 months Entity C uses gas oil derivatives because they are sufficiently liquid. For time horizons up to six months Entity C uses jet fuel contracts. Entity C's analysis of the market structure for oil and oil products and its evaluation of the relevant facts and circumstances is as follows:

(i) Entity C operates in a geographical area in which Brent is the crude oil benchmark. Crude oil is a raw material benchmark that affects the price of various refined oil products as their most basic input. Gas oil is a benchmark for refined oil products, which is used as a pricing reference for oil distillates more generally. This is also reflected in the types of derivative financial instruments for the crude oil and refined oil products markets of the environment in which Entity C operates, such as:

- The benchmark crude oil futures contract, which is for Brent crude oil;
- The benchmark gas oil futures contract, which is used as the pricing reference for distillates—for example, jet fuel spread derivatives cover the price differential between jet fuel and that benchmark gas oil; and
- The benchmark gas oil crack spread derivative (i.e., the derivative for the price differential between crude oil and gas oil—a refining margin), which is indexed to Brent crude oil.

(ii) The pricing of refined oil products does not depend on which particular crude oil is processed by a particular refinery because those refined oil products (such as gas oil or jet fuel) are standardised products.

Hence, Entity C concludes that the price risk of its jet fuel purchases includes a crude oil price risk component based on Brent crude oil and a gas oil price risk component, even though crude oil and gas oil are not specified in any contractual arrangement. Entity C concludes that these two risk components are separately identifiable and reliably measurable even though they are not contractually specified. Consequently, Entity C may designate hedging relationships for forecast jet fuel purchases on a risk components basis (for crude oil or gas oil). This analysis also means that if, for example, Entity C used crude oil derivatives based on West Texas Intermediate (WTI) crude oil, changes in the price differential between Brent crude oil and WTI crude oil would cause hedge ineffectiveness.

(d) Entity D holds a fixed-rate debt instrument. This instrument is issued in an environment with a market in which a large variety of similar debt instruments are compared by their spreads to a benchmark rate (for example, an interbank offered rate) and variable-rate instruments in that environment are typically indexed to that benchmark rate. Interest rate swaps are frequently used to manage interest rate risk on the basis of that benchmark rate, irrespective of the spread of debt instruments to that benchmark rate. The price of fixed-rate debt instruments varies directly in response to changes in the benchmark rate as they happen. Entity D concludes that the benchmark rate is a component that can be separately identified and reliably measured. Consequently, Entity D may designate hedging relationships for the fixed-rate debt instrument on a risk component basis for the benchmark interest rate risk.

AG260. When designating a risk component as a hedged item, the hedge accounting requirements apply to that risk component in the same way as they apply to other hedged items that are not risk components. For example, the qualifying criteria apply, including that the hedging relationship must meet the hedge effectiveness requirements, and any hedge ineffectiveness must be measured and recognised.

AG261. An entity can also designate only changes in the cash flows or fair value of a hedged item above or below a specified price or other variable (a 'one-sided risk'). The intrinsic value of a purchased option hedging instrument (assuming that it has the same principal terms as the designated risk), but not its time value, reflects a one-sided risk in a hedged item. For example, an entity can designate the variability of future cash flow outcomes resulting from a price increase of a forecast commodity purchase. In such a situation, the entity designates only cash flow losses that result from an increase in the price above the specified level. The hedged risk does not include the time value of a purchased option, because the time value is not a component of the forecast transaction that affects surplus or deficit.

AG262. There is a rebuttable presumption that unless inflation risk is contractually specified, it is not separately identifiable and reliably measurable and hence cannot be designated as a risk component of a financial instrument. However, in limited cases, it is possible to identify a risk component for inflation risk that is separately identifiable and reliably measurable because of the particular circumstances of the inflation environment and the relevant debt market.

AG263. For example, an entity issues debt in an environment in which inflation-linked bonds have a volume and term structure that results in a sufficiently liquid market that allows constructing a term structure of zero-coupon real interest rates. This means that for the respective currency, inflation is a relevant factor that is separately considered by the debt markets. In those circumstances the inflation risk component could be determined by discounting the cash flows of the hedged debt instrument using the term structure of zero-coupon real interest rates (i.e., in a manner similar to how a risk-free (nominal) interest rate component can be determined). Conversely, in many cases an inflation risk component is not separately identifiable and reliably measurable. For example, an entity issues only nominal interest rate debt in an environment with a market for inflation-linked bonds that is not sufficiently liquid to allow a term structure of zero-coupon real interest rates to be constructed. In this case the analysis of the market structure and of the facts and circumstances does not support the entity concluding that inflation is a relevant factor that is separately considered by the debt markets. Hence, the entity cannot overcome the rebuttable presumption that inflation risk that is not contractually specified is not separately identifiable and reliably measurable. Consequently, an inflation risk component would not be eligible for designation as the hedged item. This applies irrespective of any inflation hedging instrument that the entity has actually entered into. In particular, the entity cannot simply impute the terms and conditions of the actual inflation hedging instrument by projecting its terms and conditions onto the nominal interest rate debt.

AG264. A contractually specified inflation risk component of the cash flows of a recognised inflation-linked bond (assuming that there is no requirement to account for an embedded derivative separately) is separately identifiable and reliably measurable, as long as other cash flows of the instrument are not affected by the inflation risk component.

Components of a Nominal Amount

AG265. There are two types of components of nominal amounts that can be designated as the hedged item in a hedging relationship: a component that is a proportion of an entire item or a layer component. The type of component changes the accounting outcome. An entity shall designate the component for accounting purposes consistently with its risk management objective.

AG266. An example of a component that is a proportion is 50 per cent of the contractual cash flows of a loan.

AG267. A layer component may be specified from a defined, but open, population, or from a defined nominal amount. Examples include:

(a) Part of a monetary transaction volume, for example, the next FC10 cash flows from sales denominated in a foreign currency after the first FC20 in March 201X;[3]

(b) A part of a physical volume, for example, the bottom layer, measuring 5 million cubic metres, of the natural gas stored in location XYZ;

(c) A part of a physical or other transaction volume, for example, the first 100 barrels of the oil purchases in June 201X or the first 100 MWh of electricity sales in June 201X; or

3 In this Standard monetary amounts are denominated in 'currency units' (CU) and 'foreign currency units' (FC).

(d) A layer from the nominal amount of the hedged item, for example, the last CU80 million of a CU100 million firm commitment, the bottom layer of CU20 million of a CU100 million fixed-rate bond or the top layer of CU30 million from a total amount of CU100 million of fixed-rate debt that can be prepaid at fair value (the defined nominal amount is CU100 million).

AG268. If a layer component is designated in a fair value hedge, an entity shall specify it from a defined nominal amount. To comply with the requirements for qualifying fair value hedges, an entity shall remeasure the hedged item for fair value changes (i.e., remeasure the item for fair value changes attributable to the hedged risk). The fair value hedge adjustment must be recognised in surplus or deficit no later than when the item is derecognised. Consequently, it is necessary to track the item to which the fair value hedge adjustment relates. For a layer component in a fair value hedge, this requires an entity to track the nominal amount from which it is defined. For example, in paragraph AG267(d), the total defined nominal amount of CU100 million must be tracked in order to track the bottom layer of CU20 million or the top layer of CU30 million.

AG269. A layer component that includes a prepayment option is not eligible to be designated as a hedged item in a fair value hedge if the prepayment option's fair value is affected by changes in the hedged risk, unless the designated layer includes the effect of the related prepayment option when determining the change in the fair value of the hedged item.

Relationship Between Components and the Total Cash Flows of an Item

AG270. If a component of the cash flows of a financial or a non-financial item is designated as the hedged item, that component must be less than or equal to the total cash flows of the entire item. However, all of the cash flows of the entire item may be designated as the hedged item and hedged for only one particular risk (for example, only for those changes that are attributable to changes in a market related interest rate or a benchmark commodity price).

AG271. For example, in the case of a financial liability whose effective interest rate is below a market related interest rate, an entity cannot designate:

(a) A component of the liability equal to interest at the market rate (plus the principal amount in case of a fair value hedge); and

(b) A negative residual component.

AG272. However, in the case of a fixed-rate financial liability whose effective interest rate is (for example) 100 basis points below the market rate, an entity can designate as the hedged item the change in the value of that entire liability (i.e., principal plus interest at the market rate minus 100 basis points) that is attributable to changes in the market rate. If a fixed-rate financial instrument is hedged some time after its origination and interest rates have changed in the meantime, the entity can designate a risk component equal to a benchmark rate that is higher than the contractual rate paid on the item. The entity can do so provided that the benchmark rate is less than the effective interest rate calculated on the assumption that the entity had purchased the instrument on the day when it first designates the hedged item. For example, assume that an entity originates a fixed-rate financial asset of CU100 that has an effective interest rate of 6 per cent at a time when the market rate is 4 per cent. It begins to hedge that asset some time later when the market rate has increased to 8 per cent and the fair value of the asset has decreased to CU90. The entity calculates that if it had purchased the asset on the date it first designates the related market rate interest rate risk as the hedged item, the effective yield of the asset based on its then fair value of CU90 would have been 9.5 per cent. Because the market rate is less than this effective yield, the entity can designate the market rate component of 8 per cent that consists partly of the contractual interest cash flows and partly of the difference between the current fair value (i.e., CU90) and the amount repayable on maturity (i.e., CU100).

AG273. If a variable-rate financial liability bears interest of (for example) three-month interbank offered rate minus 20 basis points (with a floor at zero basis points), an entity can designate as the hedged item the change in the cash flows of that entire liability (i.e., three-month interbank offered rate minus 20 basis points—including the floor) that is attributable to changes in the interbank offered rate. Hence, as long as the three-month interbank offered rate forward curve for the remaining life of that liability does not fall below 20 basis points, the hedged item has the same cash flow variability as a liability that bears interest at the three-month interbank offered rate with a zero or positive spread. However, if the three-month interbank offered rate forward curve for the remaining life of that liability (or a part of it) falls below 20 basis points, the hedged item has a lower cash flow variability than a liability that bears interest at the three-month interbank offered rate with a zero or positive spread.

AG274. A similar example of a non-financial item is a specific type of crude oil from a particular oil field that is priced off the relevant benchmark crude oil. If an entity sells that crude oil under a contract using a contractual pricing formula that sets the price per barrel at the benchmark crude oil price minus CU10 with a floor of CU15, the entity can designate as the hedged item the entire cash flow variability under the sales contract that is attributable to the change in the benchmark crude oil price. However, the entity cannot designate a component that is equal to the full change in the benchmark crude oil price. Hence, as long as the forward price (for each delivery) does not fall below CU25, the hedged item has the same cash flow variability as a crude oil sale at the benchmark crude oil price (or with a positive spread). However, if the forward price for any delivery falls below CU25, the hedged item has a lower cash flow variability than a crude oil sale at the benchmark crude oil price (or with a positive spread).

Qualifying Criteria for Hedge Accounting

Hedge Effectiveness

AG275. Hedge effectiveness is the extent to which changes in the fair value or the cash flows of the hedging instrument offset changes in the fair value or the cash flows of the hedged item (for example, when the hedged item is a risk component, the relevant change in fair value or cash flows of an item is the one that is attributable to the hedged risk). Hedge ineffectiveness is the extent to which the changes in the fair value or the cash flows of the hedging instrument are greater or less than those on the hedged item.

AG276. When designating a hedging relationship and on an ongoing basis, an entity shall analyse the sources of hedge ineffectiveness that are expected to affect the hedging relationship during its term. This analysis (including any updates in accordance with paragraph AG314 arising from rebalancing a hedging relationship) is the basis for the entity's assessment of meeting the hedge effectiveness requirements.

AG277. For the avoidance of doubt, the effects of replacing the original counterparty with a clearing counterparty and making the associated changes as described in paragraph 135 shall be reflected in the measurement of the hedging instrument and therefore in the assessment of hedge effectiveness and the measurement of hedge effectiveness.

Economic Relationship Between the Hedged Item and the Hedging Instrument

AG278. The requirement that an economic relationship exists means that the hedging instrument and the hedged item have values that generally move in the opposite direction because of the same risk, which is the hedged risk. Hence, there must be an expectation that the value of the hedging instrument and the value of the hedged item will systematically change in response to movements in either the same underlying or underlyings that are economically related in such a way that they respond in a similar way to the risk that is being hedged (for example, Brent and WTI crude oil).

AG279. If the underlyings are not the same but are economically related, there can be situations in which the values of the hedging instrument and the hedged item move in the same direction, for example, because the price differential between the two related underlyings changes while the underlyings themselves do not move significantly. That is still consistent with an economic relationship between the hedging instrument and the hedged item if the values of the hedging instrument and the hedged item are still expected to typically move in the opposite direction when the underlyings move.

AG280. The assessment of whether an economic relationship exists includes an analysis of the possible behaviour of the hedging relationship during its term to ascertain whether it can be expected to meet the risk management objective. The mere existence of a statistical correlation between two variables does not, by itself, support a valid conclusion that an economic relationship exists.

The Effect of Credit Risk

AG281. Because the hedge accounting model is based on a general notion of offset between gains and losses on the hedging instrument and the hedged item, hedge effectiveness is determined not only by the economic relationship between those items (i.e., the changes in their underlyings) but also by the effect of credit risk on the value of both the hedging instrument and the hedged item. The effect of credit risk means that even if there is an economic relationship between the hedging instrument and the hedged item, the level of offset might become erratic. This can result from a change in the credit risk of either the hedging instrument or the hedged item that is of such a magnitude that the credit risk dominates the value changes that result from the economic relationship (i.e., the effect of the changes in the underlyings). A level of magnitude that gives rise to dominance is one that would result in the loss (or gain) from credit risk frustrating the effect of changes in the underlyings on the value of the hedging instrument or the hedged item, even if those changes were significant. Conversely, if during a particular period there is little change in the underlyings, the fact that even small credit risk-related changes in the value of the hedging instrument or the hedged item might affect the value more than the underlyings does not create dominance.

AG282. An example of credit risk dominating a hedging relationship is when an entity hedges an exposure to commodity price risk using an uncollateralised derivative. If the counterparty to that derivative experiences a severe deterioration in its credit standing, the effect of the changes in the counterparty's credit standing might outweigh the effect of changes in the commodity price on the fair value of the hedging instrument, whereas changes in the value of the hedged item depend largely on the commodity price changes.

Hedge Ratio

AG283. In accordance with the hedge effectiveness requirements, the hedge ratio of the hedging relationship must be the same as that resulting from the quantity of the hedged item that the entity actually hedges and the quantity of the hedging instrument that the entity actually uses to hedge that quantity of hedged item. Hence, if an entity hedges less than 100 per cent of the exposure on an item, such as 85 per cent, it shall designate the hedging relationship using a hedge ratio that is the same as that resulting from 85 per cent of the exposure and the quantity of the hedging instrument that the entity actually uses to hedge those 85 per cent. Similarly, if, for example, an entity hedges an exposure using a nominal amount of 40 units of a financial instrument, it shall designate the hedging relationship using a hedge ratio that is the same as that resulting from that quantity of 40 units (i.e., the entity must not use a hedge ratio based on a higher quantity of units that it might hold in total or a lower quantity of units) and the quantity of the hedged item that it actually hedges with those 40 units.

AG284. However, the designation of the hedging relationship using the same hedge ratio as that resulting from the quantities of the hedged item and the hedging instrument that the entity actually uses shall not reflect an imbalance between the weightings of the hedged item and the hedging instrument that would in turn create hedge ineffectiveness (irrespective of whether recognised or not) that could result in an accounting outcome that would be inconsistent with the purpose of hedge accounting. Hence, for the purpose of designating a hedging relationship, an entity must adjust the hedge ratio that results from the quantities of the hedged item and the hedging instrument that the entity actually uses if that is needed to avoid such an imbalance.

AG285. Examples of relevant considerations in assessing whether an accounting outcome is inconsistent with the purpose of hedge accounting are:

(a) Whether the intended hedge ratio is established to avoid recognising hedge ineffectiveness for cash flow hedges, or to achieve fair value hedge adjustments for more hedged items with the aim of increasing the use of fair value accounting, but without offsetting fair value changes of the hedging instrument; and

(b) Whether there is a commercial reason for the particular weightings of the hedged item and the hedging instrument, even though that creates hedge ineffectiveness. For example, an entity enters into and designates a quantity of the hedging instrument that is not the quantity that it determined as the best hedge of the hedged item because the standard volume of the hedging instruments does not allow it to enter into that exact quantity of hedging instrument (a 'lot size issue'). An example is an entity that hedges 1,000 tonnes of oil purchases with standard oil futures contracts that have a contract size of 1,000 barrels. The entity could only use either seven or eight contracts (equivalent to 980 tonnes and 1,120 tonnes respectively) to hedge the purchase volume of 1,000 tonnes. In that case, the entity designates the hedging relationship using the hedge ratio that results from the number of oil futures contracts that it actually uses, because the hedge ineffectiveness resulting from the mismatch in the weightings of the hedged item and the hedging instrument would not result in an accounting outcome that is inconsistent with the purpose of hedge accounting.

Frequency of Assessing Whether the Hedge Effectiveness Requirements are Met

AG286. An entity shall assess at the inception of the hedging relationship, and on an ongoing basis, whether a hedging relationship meets the hedge effectiveness requirements. At a minimum, an entity shall perform the ongoing assessment at each reporting date or upon a significant change in the circumstances affecting the hedge effectiveness requirements, whichever comes first. The assessment relates to expectations about hedge effectiveness and is therefore only forward-looking.

Methods for Assessing Whether the Hedge Effectiveness Requirements are Met

AG287. This Standard does not specify a method for assessing whether a hedging relationship meets the hedge effectiveness requirements. However, an entity shall use a method that captures the relevant characteristics of the hedging relationship including the sources of hedge ineffectiveness. Depending on those factors, the method can be a qualitative or a quantitative assessment.

AG288. For example, when the critical terms (such as the nominal amount, maturity and underlying) of the hedging instrument and the hedged item match or are closely aligned, it might be possible for an entity to conclude on the basis of a qualitative assessment of those critical terms that the hedging instrument and the hedged item have values that will generally move in the opposite direction because of the same risk and hence that an economic relationship exists between the hedged item and the hedging instrument (see paragraphs AG278–AG280).

AG289. The fact that a derivative is in or out of the money when it is designated as a hedging instrument does not in itself mean that a qualitative assessment is inappropriate. It depends on the circumstances whether hedge ineffectiveness arising from that fact could have a magnitude that a qualitative assessment would not adequately capture.

AG290. Conversely, if the critical terms of the hedging instrument and the hedged item are not closely aligned, there is an increased level of uncertainty about the extent of offset. Consequently, the hedge effectiveness during the term of the hedging relationship is more difficult to predict. In such a situation it might only be possible for an entity to conclude on the basis of a quantitative assessment that an economic relationship exists between the hedged item and the hedging instrument (see paragraphs AG278–AG280). In some situations a quantitative assessment might also be needed to assess whether the hedge ratio used for designating the hedging relationship meets the hedge effectiveness requirements (see paragraphs AG283–AG285). An entity can use the same or different methods for those two different purposes.

AG291. If there are changes in circumstances that affect hedge effectiveness, an entity may have to change the method for assessing whether a hedging relationship meets the hedge effectiveness requirements in order to ensure that the relevant characteristics of the hedging relationship, including the sources of hedge ineffectiveness, are still captured.

AG292. An entity's risk management is the main source of information to perform the assessment of whether a hedging relationship meets the hedge effectiveness requirements. This means that the management information (or analysis) used for decision-making purposes can be used as a basis for assessing whether a hedging relationship meets the hedge effectiveness requirements.

AG293. An entity's documentation of the hedging relationship includes how it will assess the hedge effectiveness requirements, including the method or methods used. The documentation of the hedging relationship shall be updated for any changes to the methods (see paragraph AG291).

Accounting for Qualifying Hedging Relationships

AG294. An example of a fair value hedge is a hedge of exposure to changes in the fair value of a fixed-rate debt instrument arising from changes in interest rates. Such a hedge could be entered into by the issuer or by the holder.

AG295. The purpose of a cash flow hedge is to defer the gain or loss on the hedging instrument to a period or periods in which the hedged expected future cash flows affect surplus or deficit. An example of a cash flow hedge is the use of a swap to change floating rate debt (whether measured at amortised cost or fair value) to fixed-rate debt (i.e., a hedge of a future transaction in which the future cash flows being hedged are the future interest payments). Conversely, a forecast purchase of an equity instrument that, once acquired, will be accounted for at fair value through surplus or deficit, is an example of an item that cannot be the hedged item in a cash flow hedge, because any gain or loss on the hedging instrument that would be deferred could not be appropriately reclassified to surplus or deficit during a period in which it would achieve offset. For the same reason, a forecast purchase of an equity instrument that, once acquired, will be accounted for at fair value with changes in fair value presented in other comprehensive revenue and expense also cannot be the hedged item in a cash flow hedge.

AG296. A hedge of a firm commitment (for example, a hedge of the change in fuel price relating to an unrecognised contractual commitment by an electric utility to purchase fuel at a fixed price) is a hedge of an exposure to a change in fair value. Accordingly, such a hedge is a fair value hedge. However, in accordance with paragraph 133, a hedge of the foreign currency risk of a firm commitment could alternatively be accounted for as a cash flow hedge.

Measurement of Hedge Ineffectiveness

AG297. When measuring hedge ineffectiveness, an entity shall consider the time value of money. Consequently, the entity determines the value of the hedged item on a present value basis and therefore the change in the value of the hedged item also includes the effect of the time value of money.

AG298. To calculate the change in the value of the hedged item for the purpose of measuring hedge ineffectiveness, an entity may use a derivative that would have terms that match the critical terms of the hedged item (this is commonly referred to as a 'hypothetical derivative'), and, for example for a hedge of a forecast transaction, would be calibrated using the hedged price (or rate) level. For example, if the hedge was for a two-sided risk at the current market level, the hypothetical derivative would represent a hypothetical forward contract that is calibrated to a value of nil at the time of designation of the hedging relationship. If the hedge was for example for a one-sided risk, the hypothetical derivative would represent the intrinsic value of a hypothetical option that at the time of designation of the hedging relationship is at the money if the hedged price level is the current market level, or out of the money if the hedged price level is above (or, for a hedge of a long position, below) the current market level. Using a hypothetical derivative is one possible way of calculating the change in the value of the hedged item. The hypothetical derivative replicates the hedged item and hence results in the same outcome as if that change in value was determined by a different approach. Hence, using a 'hypothetical derivative' is not a method in its own right but a mathematical expedient that can only be used to calculate the value of the hedged item. Consequently, a 'hypothetical derivative' cannot be used to include features in the value of the hedged item that only exist in the hedging instrument (but not in the hedged item). An example is debt denominated in a foreign currency (irrespective of whether it is fixed-rate or variable-rate debt). When using a hypothetical derivative to calculate the change in the value of such debt or the present value of the cumulative change in its cash flows, the hypothetical derivative cannot simply impute a charge for exchanging different currencies even though actual derivatives under which different currencies are exchanged might include such a charge (for example, cross-currency interest rate swaps).

AG299. The change in the value of the hedged item determined using a hypothetical derivative may also be used for the purpose of assessing whether a hedging relationship meets the hedge effectiveness requirements.

Rebalancing the Hedging Relationship and Changes to the Hedge Ratio

AG300. Rebalancing refers to the adjustments made to the designated quantities of the hedged item or the hedging instrument of an already existing hedging relationship for the purpose of maintaining a hedge ratio that complies with the hedge effectiveness requirements. Changes to designated quantities of a hedged item or of a hedging instrument for a different purpose do not constitute rebalancing for the purpose of this Standard.

AG301. Rebalancing is accounted for as a continuation of the hedging relationship in accordance with paragraphs AG302–AG314. On rebalancing, the hedge ineffectiveness of the hedging relationship is determined and recognised immediately before adjusting the hedging relationship.

AG302. Adjusting the hedge ratio allows an entity to respond to changes in the relationship between the hedging instrument and the hedged item that arise from their underlyings or risk variables. For example, a hedging relationship in which the hedging instrument and the hedged item have different but related underlyings changes in response to a change in the relationship between those two underlyings (for example, different but related reference indices, rates or prices). Hence, rebalancing allows the continuation of a hedging relationship in situations in which the relationship between the hedging instrument and the hedged item changes in a way that can be compensated for by adjusting the hedge ratio.

AG303. For example, an entity hedges an exposure to Foreign Currency A using a currency derivative that references Foreign Currency B and Foreign Currencies A and B are pegged (i.e., their exchange rate is maintained within a band or at an exchange rate set by a central bank or other authority). If the exchange rate between Foreign Currency A and Foreign Currency B were changed (i.e., a new band or rate was set), rebalancing the hedging relationship to reflect the new exchange rate would ensure that the hedging relationship would continue to meet the hedge effectiveness requirement for the hedge ratio in the new circumstances. In contrast, if there was a default on the currency derivative, changing the hedge ratio could not ensure that the hedging relationship would continue to meet that hedge effectiveness requirement. Hence, rebalancing does not facilitate the continuation of a hedging relationship in situations in which the relationship between the hedging instrument and the hedged item changes in a way that cannot be compensated for by adjusting the hedge ratio.

AG304. Not every change in the extent of offset between the changes in the fair value of the hedging instrument and the hedged item's fair value or cash flows constitutes a change in the relationship between the hedging instrument and the hedged item. An entity analyses the sources of hedge ineffectiveness that it expected to affect the hedging relationship during its term and evaluates whether changes in the extent of offset are:

(a) Fluctuations around the hedge ratio, which remains valid (i.e., continues to appropriately reflect the relationship between the hedging instrument and the hedged item); or

(b) An indication that the hedge ratio no longer appropriately reflects the relationship between the hedging instrument and the hedged item.

An entity performs this evaluation against the hedge effectiveness requirement for the hedge ratio, i.e., to ensure that the hedging relationship does not reflect an imbalance between the weightings of the hedged item and the hedging instrument that would create hedge ineffectiveness (irrespective of whether recognised or not) that could result in an accounting outcome that would be inconsistent with the purpose of hedge accounting. Hence, this evaluation requires judgement.

AG305. Fluctuation around a constant hedge ratio (and hence the related hedge ineffectiveness) cannot be reduced by adjusting the hedge ratio in response to each particular outcome. Hence, in such circumstances, the change in the extent of offset is a matter of measuring and recognising hedge ineffectiveness but does not require rebalancing.

AG306. Conversely, if changes in the extent of offset indicate that the fluctuation is around a hedge ratio that is different from the hedge ratio that is currently used for that hedging relationship, or that there is a trend leading away from that hedge ratio, hedge ineffectiveness can be reduced by adjusting the hedge ratio, whereas retaining the hedge ratio would increasingly produce hedge ineffectiveness. Hence, in such circumstances, an entity must evaluate whether the hedging relationship reflects an imbalance between the weightings of the hedged item and the hedging instrument that would create hedge ineffectiveness (irrespective of whether recognised or not) that could result in an accounting outcome that would be inconsistent with the purpose of hedge accounting. If the hedge ratio is adjusted, it also affects the measurement and recognition of hedge ineffectiveness because, on rebalancing, the hedge ineffectiveness of the hedging relationship must be determined and recognised immediately before adjusting the hedging relationship in accordance with paragraph AG301.

AG307. Rebalancing means that, for hedge accounting purposes, after the start of a hedging relationship an entity adjusts the quantities of the hedging instrument or the hedged item in response to changes in circumstances that affect the hedge ratio of that hedging relationship. Typically, that adjustment should reflect adjustments in the quantities of the hedging instrument and the hedged item that it actually uses. However, an entity must adjust the hedge ratio that results from the quantities of the hedged item or the hedging instrument that it actually uses if:

(a) The hedge ratio that results from changes to the quantities of the hedging instrument or the hedged item that the entity actually uses would reflect an imbalance that would create hedge ineffectiveness that could result in an accounting outcome that would be inconsistent with the purpose of hedge accounting; or

(b) An entity would retain quantities of the hedging instrument and the hedged item that it actually uses, resulting in a hedge ratio that, in new circumstances, would reflect an imbalance that would create hedge ineffectiveness that could result in an accounting outcome that would be inconsistent with the purpose of hedge accounting (i.e., an entity must not create an imbalance by omitting to adjust the hedge ratio).

AG308. Rebalancing does not apply if the risk management objective for a hedging relationship has changed. Instead, hedge accounting for that hedging relationship shall be discontinued (despite that an entity might designate a new hedging relationship that involves the hedging instrument or hedged item of the previous hedging relationship as described in paragraph AG321).

AG309. If a hedging relationship is rebalanced, the adjustment to the hedge ratio can be effected in different ways:

(a) The weighting of the hedged item can be increased (which at the same time reduces the weighting of the hedging instrument) by:

(i) Increasing the volume of the hedged item; or

(ii) Decreasing the volume of the hedging instrument.

(b) The weighting of the hedging instrument can be increased (which at the same time reduces the weighting of the hedged item) by:

(i) Increasing the volume of the hedging instrument; or

(ii) Decreasing the volume of the hedged item.

Changes in volume refer to the quantities that are part of the hedging relationship. Hence, decreases in volumes do not necessarily mean that the items or transactions no longer exist, or are no longer expected to occur, but that they are not part of the hedging relationship. For example, decreasing the volume of the hedging instrument can result in the entity retaining a derivative, but only part of it might remain a hedging instrument of the hedging relationship. This could occur if the rebalancing could be effected only by reducing the volume of the hedging instrument in the hedging relationship, but with the entity retaining the volume that is no longer needed. In that case, the undesignated part of the derivative would be accounted for at fair value through surplus or deficit (unless it was designated as a hedging instrument in a different hedging relationship).

AG310. Adjusting the hedge ratio by increasing the volume of the hedged item does not affect how the changes in the fair value of the hedging instrument are measured. The measurement of the changes in the value of the hedged item related to the previously designated volume also remains unaffected. However, from the date of rebalancing, the changes in the value of the hedged item also include the change in the value of the additional volume of the hedged item. These changes are measured starting from, and by reference to, the date of rebalancing instead of the date on which the hedging relationship was designated. For example, if an entity originally hedged a volume of 100 tonnes of a commodity at a forward price of CU80 (the forward price at inception of the hedging relationship) and added a volume of 10 tonnes on rebalancing when the forward price was CU90, the hedged item after rebalancing would comprise two layers: 100 tonnes hedged at CU80 and 10 tonnes hedged at CU90.

AG311. Adjusting the hedge ratio by decreasing the volume of the hedging instrument does not affect how the changes in the value of the hedged item are measured. The measurement of the changes in the fair value of the hedging instrument related to the volume that continues to be designated also remains unaffected. However, from the date of rebalancing, the volume by which the hedging instrument was decreased is no longer part of the hedging relationship. For example, if an entity originally hedged the price risk of a commodity using a derivative volume of 100 tonnes as the hedging instrument and reduces that volume by 10 tonnes on rebalancing, a nominal amount of 90 tonnes of the hedging instrument volume would remain (see paragraph AG309 for the consequences for the derivative volume (i.e., the 10 tonnes) that is no longer a part of the hedging relationship).

AG312. Adjusting the hedge ratio by increasing the volume of the hedging instrument does not affect how the changes in the value of the hedged item are measured. The measurement of the changes in the fair value of the hedging instrument related to the previously designated volume also remains unaffected. However, from the date of rebalancing, the changes in the fair value of the hedging instrument also include the changes in the value of the additional volume of the hedging instrument. The changes are measured starting from, and by reference to, the date of rebalancing instead of the date on which the hedging relationship was designated. For example, if an entity originally hedged the price risk of a commodity using a derivative volume of 100 tonnes as the hedging instrument and added a volume of 10 tonnes on rebalancing, the hedging instrument after rebalancing would comprise a total derivative volume of 110 tonnes. The change in the fair value of the hedging instrument is the total change in the fair value of the derivatives that make up the total volume of 110 tonnes. These derivatives could (and probably would) have different critical terms, such as their forward rates, because they were entered into at different points in time (including the possibility of designating derivatives into hedging relationships after their initial recognition).

AG313. Adjusting the hedge ratio by decreasing the volume of the hedged item does not affect how the changes in the fair value of the hedging instrument are measured. The measurement of the changes in the value of the hedged item related to the volume that continues to be designated also remains unaffected. However, from the date of rebalancing, the volume by which the hedged item was decreased is no longer part of the hedging relationship. For example, if an entity originally hedged a volume of 100 tonnes of a commodity at a forward price of CU80 and reduces that volume by 10 tonnes on rebalancing, the hedged item after rebalancing would be 90 tonnes hedged at CU80. The 10 tonnes of the hedged item that are no longer part of the hedging relationship would be accounted for in accordance with the requirements for the discontinuation of hedge accounting (see paragraphs 135–136 and AG315–AG321).

AG314. When rebalancing a hedging relationship, an entity shall update its analysis of the sources of hedge ineffectiveness that are expected to affect the hedging relationship during its (remaining) term (see paragraph AG276). The documentation of the hedging relationship shall be updated accordingly.

Discontinuation of Hedge Accounting

AG315. Discontinuation of hedge accounting applies prospectively from the date on which the qualifying criteria are no longer met.

AG316. An entity shall not de-designate and thereby discontinue a hedging relationship that:

(a) Still meets the risk management objective on the basis of which it qualified for hedge accounting (i.e., the entity still pursues that risk management objective); and

(b) Continues to meet all other qualifying criteria (after taking into account any rebalancing of the hedging relationship, if applicable).

AG317. For the purposes of this Standard, an entity's risk management strategy is distinguished from its risk management objectives. The risk management strategy is established at the highest level at which an entity determines how it manages its risk. Risk management strategies typically identify the risks to which the entity is exposed and set out how the entity responds to them. A risk management strategy is typically in place for a longer period and may include some flexibility to react to changes in circumstances that occur while that strategy is in place (for example, different interest rate or commodity price levels that result in a different extent of hedging). This is normally set out in a general document that is cascaded down through an entity through policies containing more specific guidelines. In contrast, the risk management objective for a hedging relationship applies at the level of a particular hedging relationship. It relates to how the particular hedging instrument that has been designated is used to hedge the particular exposure that has been designated as the hedged item. Hence, a risk management strategy can involve many different hedging relationships whose risk management objectives relate to executing that overall risk management strategy. For example:

(a) An entity has a strategy of managing its interest rate exposure on debt funding that sets ranges for the overall entity for the mix between variable-rate and fixed-rate funding. The strategy is to maintain between 20 per cent and 40 per cent of the debt at fixed rates. The entity decides from time to time how to execute this strategy (i.e., where it positions itself within the 20 per cent to 40 per cent range for fixed-rate interest exposure) depending on the level of interest rates. If interest rates are low the entity fixes the interest for more debt than when interest rates are high. The entity's debt is CU100 of variable-rate debt of which CU30 is swapped into a fixed-rate exposure. The entity takes advantage of low interest rates to issue an additional CU50 of debt to finance a major investment, which the entity does by issuing a fixed-rate bond. In the light of the low interest rates, the entity decides to set its fixed interest-rate exposure to 40 per cent of the total debt by reducing by CU20 the extent to which it previously hedged its variable-rate exposure, resulting in CU60 of fixed-rate exposure. In this situation the risk management strategy itself remains unchanged. However, in contrast the entity's execution of that strategy has changed and this means that, for CU20 of variable-rate exposure that was previously hedged, the risk management objective has changed (i.e., at the hedging relationship level). Consequently, in this situation hedge accounting must be discontinued for CU20 of the previously hedged variable-rate exposure. This could involve reducing the swap position by a CU20 nominal amount but, depending on the circumstances, an entity might retain that swap volume and, for example, use it for hedging a different exposure or it might become part of a trading book. Conversely, if an entity instead swapped a part of its new fixed-rate debt into a variable-rate exposure, hedge accounting would have to be continued for its previously hedged variable-rate exposure.

(b) Some exposures result from positions that frequently change, for example, the interest rate risk of an open portfolio of debt instruments. The addition of new debt instruments and the derecognition of debt instruments continuously change that exposure (i.e., it is different from simply running off a position that matures). This is a dynamic process in which both the exposure and the hedging instruments used to manage it do not remain the same for long. Consequently, an entity with such an exposure frequently adjusts the hedging instruments used to manage the interest rate risk as the exposure changes. For example, debt instruments with 24 months' remaining maturity are designated as the hedged item for interest rate risk for 24 months. The same procedure is applied to other time buckets or maturity periods. After a short period of time, the entity discontinues all, some or a part of the previously designated hedging relationships for maturity periods and designates new hedging relationships for maturity periods on the basis of their size and the hedging instruments that exist at that time. The discontinuation of hedge accounting in this situation reflects that those hedging relationships are established in such a way that the entity looks at a new hedging instrument and a new hedged item instead of the hedging instrument and the hedged item that were designated previously. The risk management strategy remains the same, but there is no risk management objective that continues for those previously designated hedging relationships, which as such no longer exist. In such a situation, the discontinuation of hedge accounting applies to the extent to which the risk management objective has changed. This depends on the situation of an entity and could, for example, affect all or only some hedging relationships of a maturity period, or only part of a hedging relationship.

(c) An entity has a risk management strategy whereby it manages the foreign currency risk of forecast sales and the resulting receivables. Within that strategy the entity manages the foreign currency risk as a particular hedging relationship only up to the point of the recognition of the receivable. Thereafter, the entity no longer manages the foreign currency risk on the basis of that particular hedging relationship. Instead, it manages together the foreign currency risk from receivables, payables and derivatives (that do not relate to forecast transactions that are still pending) denominated in the same foreign currency. For accounting purposes, this works as a 'natural' hedge because the gains and losses from the foreign currency risk on all of those items are immediately recognised in surplus or deficit. Consequently, for accounting purposes, if the hedging relationship is designated for the period up to the payment date, it must be discontinued when the receivable is recognised, because the risk management objective of the original hedging relationship no longer applies. The foreign currency risk is now managed within the same strategy but on a different basis. Conversely, if an entity had a different risk management objective and managed the foreign currency risk as one continuous hedging relationship specifically for that forecast sales amount and the resulting receivable until the settlement date, hedge accounting would continue until that date.

AG318. The discontinuation of hedge accounting can affect:

(a) A hedging relationship in its entirety; or

(b) A part of a hedging relationship (which means that hedge accounting continues for the remainder of the hedging relationship).

AG319. A hedging relationship is discontinued in its entirety when, as a whole, it ceases to meet the qualifying criteria. For example:

(a) The hedging relationship no longer meets the risk management objective on the basis of which it qualified for hedge accounting (i.e., the entity no longer pursues that risk management objective);

(b) The hedging instrument or instruments have been sold or terminated (in relation to the entire volume that was part of the hedging relationship); or

(c) There is no longer an economic relationship between the hedged item and the hedging instrument or the effect of credit risk starts to dominate the value changes that result from that economic relationship.

AG320. A part of a hedging relationship is discontinued (and hedge accounting continues for its remainder) when only a part of the hedging relationship ceases to meet the qualifying criteria. For example:

(a) On rebalancing of the hedging relationship, the hedge ratio might be adjusted in such a way that some of the volume of the hedged item is no longer part of the hedging relationship (see paragraph AG313); hence, hedge accounting is discontinued only for the volume of the hedged item that is no longer part of the hedging relationship; or

(b) When the occurrence of some of the volume of the hedged item that is (or is a component of) a forecast transaction is no longer highly probable, hedge accounting is discontinued only for the volume of the hedged item whose occurrence is no longer highly probable. However, if an entity has a history of having designated hedges of forecast transactions and having subsequently determined that the forecast transactions are no longer expected to occur, the entity's ability to predict forecast transactions accurately is called into question when predicting similar forecast transactions. This affects the assessment of whether similar forecast transactions are highly probable (see paragraph 124) and hence whether they are eligible as hedged items.

AG321. An entity can designate a new hedging relationship that involves the hedging instrument or hedged item of a previous hedging relationship for which hedge accounting was (in part or in its entirety) discontinued. This does not constitute a continuation of a hedging relationship but is a restart. For example:

(a) A hedging instrument experiences such a severe credit deterioration that the entity replaces it with a new hedging instrument. This means that the original hedging relationship failed to achieve the risk management objective and is hence discontinued in its entirety. The new hedging instrument is designated as the hedge of the same exposure that was hedged previously and forms a new hedging relationship. Hence, the changes in the fair value or the cash flows of the hedged item are measured starting from, and by reference to, the date of designation of the new hedging relationship instead of the date on which the original hedging relationship was designated.

(b) A hedging relationship is discontinued before the end of its term. The hedging instrument in that hedging relationship can be designated as the hedging instrument in another hedging relationship (for example, when adjusting the hedge ratio on rebalancing by increasing the volume of the hedging instrument or when designating a whole new hedging relationship).

Accounting for the Time Value of Options

AG322. An option can be considered as being related to a time period because its time value represents a charge for providing protection for the option holder over a period of time. However, the relevant aspect for the purpose of assessing whether an option hedges a transaction or time-period related hedged item are the characteristics of that hedged item, including how and when it affects surplus or deficit. Hence, an entity shall assess the type of hedged item (see paragraph 144(a)) on the basis of the nature of the hedged item (regardless of whether the hedging relationship is a cash flow hedge or a fair value hedge):

(a) The time value of an option relates to a transaction related hedged item if the nature of the hedged item is a transaction for which the time value has the character of costs of that transaction. An example is when the time value of an option relates to a hedged item that results in the recognition of an item whose initial measurement includes transaction costs (for example, an entity hedges a commodity purchase, whether it is a forecast transaction or a firm commitment, against the commodity price risk and includes the transaction costs in the initial measurement of the inventory). As a consequence of including the time value of the option in the initial measurement of the particular hedged item, the time value affects surplus or deficit at the same time as that hedged item. Similarly, an entity that hedges a sale of a commodity, whether it is a forecast transaction or a firm commitment, would include the time value of the option as part of the cost related to that sale (hence, the time value would be recognised in surplus or deficit in the same period as the revenue from the hedged sale).

(b) The time value of an option relates to a time-period related hedged item if the nature of the hedged item is such that the time value has the character of a cost for obtaining protection against a risk over a particular period of time (but the hedged item does not result in a transaction that involves the notion of a transaction cost in accordance with (a)). For example, if commodity inventory is hedged against a fair value decrease for six months using a commodity option with a corresponding life, the time value of the option would be allocated to surplus or deficit (i.e., amortised on a systematic and rational basis) over that six-month period. Another example is a hedge of a net investment in a foreign operation that is hedged for 18 months using a foreign-exchange option, which would result in allocating the time value of the option over that 18-month period.

AG323. The characteristics of the hedged item, including how and when the hedged item affects surplus or deficit, also affect the period over which the time value of an option that hedges a time-period related hedged item is amortised, which is consistent with the period over which the option's intrinsic value can affect surplus or deficit in accordance with hedge accounting. For example, if an interest rate option (a cap) is used to provide protection against increases in the interest expense on a floating rate bond, the time value of that cap is amortised to surplus or deficit over the same period over which any intrinsic value of the cap would affect surplus or deficit:

(a) If the cap hedges increases in interest rates for the first three years out of a total life of the floating rate bond of five years, the time value of that cap is amortised over the first three years; or

(b) If the cap is a forward start option that hedges increases in interest rates for years two and three out of a total life of the floating rate bond of five years, the time value of that cap is amortised during years two and three.

AG324. The accounting for the time value of options in accordance with paragraph 144 also applies to a combination of a purchased and a written option (one being a put option and one being a call option) that at the date of designation as a hedging instrument has a net nil time value (commonly referred to as a 'zero-cost collar'). In that case, an entity shall recognise any changes in time value in other comprehensive revenue and expense, even though the cumulative change in time value over the total period of the hedging relationship is nil. Hence, if the time value of the option relates to:

(a) A transaction related hedged item, the amount of time value at the end of the hedging relationship that adjusts the hedged item or that is reclassified to surplus or deficit (see paragraph 144(b)) would be nil.

(b) A time-period related hedged item, the amortisation expense related to the time value is nil.

AG325. The accounting for the time value of options in accordance with paragraph 144 applies only to the extent that the time value relates to the hedged item (aligned time value). The time value of an option relates to the hedged item if the critical terms of the option (such as the nominal amount, life and underlying) are aligned with the hedged item. Hence, if the critical terms of the option and the hedged item are not fully aligned, an entity shall determine the aligned time value, i.e., how much of the time value included in the premium (actual time value) relates to the hedged item (and therefore should be treated in accordance with paragraph 144). An entity determines the aligned time value using the valuation of the option that would have critical terms that perfectly match the hedged item.

AG326. If the actual time value and the aligned time value differ, an entity shall determine the amount that is accumulated in a separate component of net assets/equity in accordance with paragraph 144 as follows:

(a) If, at inception of the hedging relationship, the actual time value is higher than the aligned time value, the entity shall:

(i) Determine the amount that is accumulated in a separate component of net assets/equity on the basis of the aligned time value; and

(ii) Account for the differences in the fair value changes between the two time values in surplus or deficit.

(b) If, at inception of the hedging relationship, the actual time value is lower than the aligned time value, the entity shall determine the amount that is accumulated in a separate component of net assets/equity by reference to the lower of the cumulative change in fair value of:

(i) The actual time value; and

(ii) The aligned time value.

Any remainder of the change in fair value of the actual time value shall be recognised in surplus or deficit.

Accounting for the Forward Element of Forward Contracts and Foreign Currency Basis Spreads of Financial Instruments

AG327. A forward contract can be considered as being related to a time period because its forward element represents charges for a period of time (which is the tenor for which it is determined). However, the relevant aspect for the purpose of assessing whether a hedging instrument hedges a transaction or time-period related hedged item are the characteristics of that hedged item, including how and when it affects surplus or deficit. Hence, an entity shall assess the type of hedged item (see paragraphs 144(a) and 145) on the basis of the nature of the hedged item (regardless of whether the hedging relationship is a cash flow hedge or a fair value hedge):

(a) The forward element of a forward contract relates to a transaction related hedged item if the nature of the hedged item is a transaction for which the forward element has the character of costs of that transaction. An example is when the forward element relates to a hedged item that results in the recognition of an item whose initial measurement includes transaction costs (for example, an entity hedges an inventory purchase denominated in a foreign currency, whether it is a forecast transaction or a firm commitment, against foreign currency risk and includes the transaction costs in the initial measurement of the inventory). As a consequence of including the forward element in the initial measurement of the particular hedged item, the forward element affects surplus or deficit at the same time as that hedged item. Similarly, an entity that hedges a sale of a commodity denominated in a foreign currency against foreign currency risk, whether it is a forecast transaction or a firm commitment, would include the forward element as part of the cost that is related to that sale (hence, the forward element would be recognised in surplus or deficit in the same period as the revenue from the hedged sale).

(b) The forward element of a forward contract relates to a time-period related hedged item if the nature of the hedged item is such that the forward element has the character of a cost for obtaining protection against a risk over a particular period of time (but the hedged item does not result in a transaction that involves the notion of a transaction cost in accordance with (a)). For example, if commodity inventory is hedged against changes in fair value for six months using a commodity forward contract with a corresponding life, the forward element of the forward contract would be allocated to surplus or deficit (i.e., amortised on a systematic and rational basis) over that six-month period. Another example is a hedge of a net investment in a foreign operation that is hedged for 18 months using a foreign-exchange forward contract, which would result in allocating the forward element of the forward contract over that 18-month period.

AG328. The characteristics of the hedged item, including how and when the hedged item affects surplus or deficit, also affect the period over which the forward element of a forward contract that hedges a time-period related hedged item is amortised, which is over the period to which the forward element relates. For example, if a forward contract hedges the exposure to variability in three-month interest rates for a three-month period that starts in six months' time, the forward element is amortised during the period that spans months seven to nine.

AG329. The accounting for the forward element of a forward contract in accordance with paragraph 145 also applies if, at the date on which the forward contract is designated as a hedging instrument, the forward element is nil. In that case, an entity shall recognise any fair value changes attributable to the forward element in other comprehensive revenue and expense, even though the cumulative fair value change attributable to the forward element over the total period of the hedging relationship is nil. Hence, if the forward element of a forward contract relates to:

(a) A transaction related hedged item, the amount in respect of the forward element at the end of the hedging relationship that adjusts the hedged item or that is reclassified to surplus or deficit (see paragraphs 144(b) and 145) would be nil.

(b) A time-period related hedged item, the amortisation amount related to the forward element is nil.

AG330. The accounting for the forward element of forward contracts in accordance with paragraph 145 applies only to the extent that the forward element relates to the hedged item (aligned forward element). The forward element of a forward contract relates to the hedged item if the critical terms of the forward contract (such as the nominal amount, life and underlying) are aligned with the hedged item. Hence, if the critical terms of the forward contract and the hedged item are not fully aligned, an entity shall determine the aligned forward element, i.e., how much of the forward element included in the forward contract (actual forward element) relates to the hedged item (and therefore should be treated in accordance with paragraph 145). An entity determines the aligned forward element using the valuation of the forward contract that would have critical terms that perfectly match the hedged item.

AG331. If the actual forward element and the aligned forward element differ, an entity shall determine the amount that is accumulated in a separate component of net assets/equity in accordance with paragraph 145 as follows:

(a) If, at inception of the hedging relationship, the absolute amount of the actual forward element is higher than that of the aligned forward element the entity shall:

(i) Determine the amount that is accumulated in a separate component of net assets/equity on the basis of the aligned forward element; and

(ii) Account for the differences in the fair value changes between the two forward elements in surplus or deficit.

(b) If, at inception of the hedging relationship, the absolute amount of the actual forward element is lower than that of the aligned forward element, the entity shall determine the amount that is accumulated in a separate component of net assets/equity by reference to the lower of the cumulative change in fair value of:

(i) The absolute amount of the actual forward element; and

(ii) The absolute amount of the aligned forward element.

Any remainder of the change in fair value of the actual forward element shall be recognised in surplus or deficit.

AG332. When an entity separates the foreign currency basis spread from a financial instrument and excludes it from the designation of that financial instrument as the hedging instrument (see paragraph 119(b)), the application guidance in paragraphs AG327–AG331 applies to the foreign currency basis spread in the same manner as it is applied to the forward element of a forward contract.

Hedge of a Group of Items

Hedge of a Net Position

Eligibility for Hedge Accounting and Designation of a Net Position

AG333. A net position is eligible for hedge accounting only if an entity hedges on a net basis for risk management purposes. Whether an entity hedges in this way is a matter of fact (not merely of assertion or documentation). Hence, an entity cannot apply hedge accounting on a net basis solely to achieve a particular accounting outcome if that would not reflect its risk management approach. Net position hedging must form part of an established risk management strategy. Normally this would be approved by key management personnel as defined in PBE IPSAS 20.

AG334. For example, Entity A, whose functional currency is its local currency, has a firm commitment to pay FC150,000 for advertising expenses in nine months' time and a firm commitment to sell finished goods for FC150,000 in 15 months' time. Entity A enters into a foreign currency derivative that settles in nine months' time under which it receives FC100 and pays CU70. Entity A has no other exposures to FC. Entity A does not manage foreign currency risk on a net basis. Hence, Entity A cannot apply hedge accounting for a hedging relationship between the foreign currency derivative and a net position of FC100 (consisting of FC150,000 of the firm purchase commitment—i.e., advertising services—and FC149,900 (of the FC150,000) of the firm sale commitment) for a nine-month period.

AG335. If Entity A did manage foreign currency risk on a net basis and did not enter into the foreign currency derivative (because it increases its foreign currency risk exposure instead of reducing it), then the entity would be in a natural hedged position for nine months. Normally, this hedged position would not be reflected in the financial statements because the transactions are recognised in different reporting periods in the future. The nil net position would be eligible for hedge accounting only if the conditions in paragraph 151 are met.

AG336. When a group of items that constitute a net position is designated as a hedged item, an entity shall designate the overall group of items that includes the items that can make up the net position. An entity is not permitted to designate a non-specific abstract amount of a net position. For example, an entity has a group of firm sale commitments in nine months' time for FC100 and a group of firm purchase commitments in 18 months' time for FC120. The entity cannot designate an abstract amount of a net position up to FC20. Instead, it must designate a gross amount of purchases and a gross amount of sales that together give rise to the hedged net position. An entity shall designate gross positions that give rise to the net position so that the entity is able to comply with the requirements for the accounting for qualifying hedging relationships.

Application of the Hedge Effectiveness Requirements to a Hedge of a Net Position

AG337. When an entity determines whether the hedge effectiveness requirements of paragraph 129(c) are met when it hedges a net position, it shall consider the changes in the value of the items in the net position that have a similar effect as the hedging instrument in conjunction with the fair value change on the hedging instrument. For example, an entity has a group of firm sale commitments in nine months' time for FC100 and a group of firm purchase commitments in 18 months' time for FC120. It hedges the foreign currency risk of the net position of FC20 using a forward exchange contract for FC20. When determining whether the hedge effectiveness requirements of paragraph 129(c) are met, the entity shall consider the relationship between:

(a) The fair value change on the forward exchange contract together with the foreign currency risk related changes in the value of the firm sale commitments; and

(b) The foreign currency risk related changes in the value of the firm purchase commitments.

AG338. Similarly, if in the example in paragraph AG337 the entity had a nil net position it would consider the relationship between the foreign currency risk related changes in the value of the firm sale commitments and the foreign currency risk related changes in the value of the firm purchase commitments when determining whether the hedge effectiveness requirements of paragraph 129(c) are met.

Cash Flow Hedges that Constitute a Net Position

AG339. When an entity hedges a group of items with offsetting risk positions (i.e., a net position), the eligibility for hedge accounting depends on the type of hedge. If the hedge is a fair value hedge, then the net position may be eligible as a hedged item. If, however, the hedge is a cash flow hedge, then the net position can only be eligible as a hedged item if it is a hedge of foreign currency risk and the designation of that net position specifies the reporting period in which the forecast transactions are expected to affect surplus or deficit and also specifies their nature and volume.

AG340. For example, an entity has a net position that consists of a bottom layer of FC100 of sales and a bottom layer of FC150 of purchases. Both sales and purchases are denominated in the same foreign currency.

In order to sufficiently specify the designation of the hedged net position, the entity specifies in the original documentation of the hedging relationship that sales can be of Product A or Product B and purchases can be of Machinery Type A, Machinery Type B and Raw Material A. The entity also specifies the volumes of the transactions by each nature. The entity documents that the bottom layer of sales (FC100) is made up of a forecast sales volume of the first FC70 of Product A and the first FC30 of Product B. If those sales volumes are expected to affect surplus or deficit in different reporting periods, the entity would include that in the documentation, for example, the first FC70 from sales of Product A that are expected to affect surplus or deficit in the first reporting period and the first FC30 from sales of Product B that are expected to affect surplus or deficit in the second reporting period. The entity also documents that the bottom layer of the purchases (FC150) is made up of purchases of the first FC60 of Machinery Type A, the first FC40 of Machinery Type B and the first FC50 of Raw Material A. If those purchase volumes are expected to affect surplus or deficit in different reporting periods, the entity would include in the documentation a disaggregation of the purchase volumes by the reporting periods in which they are expected to affect surplus or deficit (similarly to how it documents the sales volumes). For example, the forecast transaction would be specified as:

(a) The first FC60 of purchases of Machinery Type A that are expected to affect surplus or deficit from the third reporting period over the next ten reporting periods;

(b) The first FC40 of purchases of Machinery Type B that are expected to affect surplus or deficit from the fourth reporting period over the next 20 reporting periods; and

(c) The first FC50 of purchases of Raw Material A that are expected to be received in the third reporting period and sold, i.e., affect surplus or deficit, in that and the next reporting period.

Specifying the nature of the forecast transaction volumes would include aspects such as the depreciation pattern for items of property, plant and equipment of the same kind, if the nature of those items is such that the depreciation pattern could vary depending on how the entity uses those items. For example, if the entity uses items of Machinery Type A in two different production processes that result in straight-line depreciation over ten reporting periods and the units of production method respectively, its documentation of the forecast purchase volume for Machinery Type A would disaggregate that volume by which of those depreciation patterns will apply.

AG341. For a cash flow hedge of a net position, the amounts determined in accordance with paragraph 140 shall include the changes in the value of the items in the net position that have a similar effect as the hedging instrument in conjunction with the fair value change on the hedging instrument. However, the changes in the value of the items in the net position that have a similar effect as the hedging instrument are recognised only once the transactions that they relate to are recognised, such as when a forecast sale is recognised as revenue. For example, an entity has a group of highly probable forecast sales in nine months' time for FC100 and a group of highly probable forecast purchases in 18 months' time for FC120. It hedges the foreign currency risk of the net position of FC20 using a forward exchange contract for FC20. When determining the amounts that are recognised in the cash flow hedge reserve in accordance with paragraph 140(a)–140(b), the entity compares:

(a) The fair value change on the forward exchange contract together with the foreign currency risk related changes in the value of the highly probable forecast sales; with

(b) The foreign currency risk related changes in the value of the highly probable forecast purchases.

However, the entity recognises only amounts related to the forward exchange contract until the highly probable forecast sales transactions are recognised in the financial statements, at which time the gains or losses on those forecast transactions are recognised (i.e., the change in the value attributable to the change in the foreign exchange rate between the designation of the hedging relationship and the recognition of revenue).

AG342. Similarly, if in the example the entity had a nil net position it would compare the foreign currency risk related changes in the value of the highly probable forecast sales with the foreign currency risk related changes in the value of the highly probable forecast purchases. However, those amounts are recognised only once the related forecast transactions are recognised in the financial statements.

Layers of Groups of Items Designated as the Hedged Item

AG343. For the same reasons noted in paragraph AG268, designating layer components of groups of existing items requires the specific identification of the nominal amount of the group of items from which the hedged layer component is defined.

AG344. A hedging relationship can include layers from several different groups of items. For example, in a hedge of a net position of a group of assets and a group of liabilities, the hedging relationship can comprise, in combination, a layer component of the group of assets and a layer component of the group of liabilities.

Presentation of Hedging Instrument Gains or Losses

AG345. If items are hedged together as a group in a cash flow hedge, they might affect different line items in the statement of comprehensive revenue and expense. The presentation of hedging gains or losses in that statement depends on the group of items.

AG346. If the group of items does not have any offsetting risk positions (for example, a group of foreign currency expenses that affect different line items in the statement of comprehensive revenue and expense that are hedged for foreign currency risk) then the reclassified hedging instrument gains or losses shall be apportioned to the line items affected by the hedged items. This apportionment shall be done on a systematic and rational basis and shall not result in the grossing up of the net gains or losses arising from a single hedging instrument.

AG347. If the group of items does have offsetting risk positions (for example, a group of sales and expenses denominated in a foreign currency hedged together for foreign currency risk) then an entity shall present the hedging gains or losses in a separate line item in the statement of comprehensive revenue and expense. Consider, for example, a hedge of the foreign currency risk of a net position of foreign currency sales of FC100 and foreign currency expenses of FC80 using a forward exchange contract for FC20. The gain or loss on the forward exchange contract that is reclassified from the cash flow hedge reserve to surplus or deficit (when the net position affects surplus or deficit) shall be presented in a separate line item from the hedged sales and expenses. Moreover, if the sales occur in an earlier period than the expenses, the sales revenue is still measured at the spot exchange rate in accordance with PBE IPSAS 4. The related hedging gain or loss is presented in a separate line item, so that surplus or deficit reflects the effect of hedging the net position, with a corresponding adjustment to the cash flow hedge reserve. When the hedged expenses affect surplus or deficit in a later period, the hedging gain or loss previously recognised in the cash flow hedge reserve on the sales is reclassified to surplus or deficit and presented as a separate line item from those that include the hedged expenses, which are measured at the spot exchange rate in accordance with PBE IPSAS 4.

AG348. For some types of fair value hedges, the objective of the hedge is not primarily to offset the fair value change of the hedged item but instead to transform the cash flows of the hedged item. For example, an entity hedges the fair value interest rate risk of a fixed-rate debt instrument using an interest rate swap. The entity’s hedge objective is to transform the fixed-interest cash flows into floating interest cash flows. This objective is reflected in the accounting for the hedging relationship by accruing the net interest accrual on the interest rate swap in surplus or deficit. In the case of a hedge of a net position (for example, a net position of a fixed-rate asset and a fixed-rate liability), this net interest accrual must be presented in a separate line item in the statement of comprehensive revenue and expense. This is to avoid the grossing up of a single instrument’s net gains or losses into offsetting gross amounts and recognising them in different line items (for example, this avoids grossing up a net interest receipt on a single interest rate swap into gross interest revenue and gross interest expense).

Effective Date and Transition

Transition

Financial Assets Held for Trading

AG349. At the date of initial application of this Standard, an entity must determine whether the objective of the entity’s management model for managing any of its financial assets meets the condition in paragraph 40(a) or the condition in paragraph 41(a) or if a financial asset is eligible for the election in paragraph 106. For that purpose, an entity shall determine whether financial assets meet the definition of held for trading as if the entity had purchased the assets at the date of initial application.

Impairment

AG350. On transition, an entity should seek to approximate the credit risk on initial recognition by considering all reasonable and supportable information that is available without undue cost or effort. An entity is not required to undertake an exhaustive search for information when determining, at the date of transition, whether there have been significant increases in credit risk since initial recognition. If an entity is unable to make this determination without undue cost or effort paragraph 178 applies.

AG351. In order to determine the loss allowance on financial instruments initially recognised (or loan commitments or financial guarantee contracts to which the entity became a party to the contract) prior to the date of initial application, both on transition and until the derecognition of those items an entity shall consider information that is relevant in determining or approximating the credit risk at initial recognition. In order to determine or approximate the initial credit risk, an entity may consider internal and external information, including portfolio information, in accordance with paragraphs AG165–AG170.

AG352. An entity with little historical information may use information from internal reports and statistics (that may have been generated when deciding whether to launch a new product), information about similar products or peer group experience for comparable financial instruments, if relevant.

Appendix B – Hedges of a Net Investment in a Foreign Operation

This Appendix is an integral part of PBE IPSAS 41.

Introduction

B1. Many reporting entities have investments in foreign operations (as defined in PBE IPSAS 4 *The Effects of Changes in Foreign Exchange Rates* paragraph 10). Such foreign operations may be controlled entities, associates, joint ventures or branches. PBE IPSAS 4 requires an entity to determine the functional currency of each of its foreign operations as the currency of the primary economic environment of that operation. When translating the results and financial position of a foreign operation into a presentation currency, the entity is required to recognise foreign exchange differences in other comprehensive revenue and expense until it disposes of the foreign operation.

B2. Hedge accounting of the foreign currency risk arising from a net investment in a foreign operation will apply only when the net assets of that foreign operation are included in the financial statements. This will be the case for consolidated financial statements, financial statements in which investments such as associates or joint ventures are accounted for using the equity method and financial statements that include a branch or joint operations as defined in PBE IPSAS 37 *Joint Arrangements*. The item being hedged with respect to the foreign currency risk arising from the net investment in a foreign operation may be an amount of net assets equal to or less than the carrying amount of the net assets of the foreign operation.

B3. PBE IPSAS 41 *Financial Instruments* requires the designation of an eligible hedged item and eligible hedging instruments in a hedge accounting relationship. If there is a designated hedging relationship, in the case of a net investment hedge, the gain or loss on the hedging instrument that is determined to be an effective hedge of the net investment is recognised in other comprehensive revenue and expense and is included with the foreign exchange differences arising on translation of the results and financial position of the foreign operation.

B4. This Appendix applies to an entity that hedges the foreign currency risk arising from its net investments in foreign operations and wishes to qualify for hedge accounting in accordance with PBE IPSAS 41. It should not be applied by analogy to other types of hedge accounting. This Appendix refers to such an entity as a controlling entity and to the financial statements in which the net assets of foreign operations are included as consolidated financial statements. All references to a controlling entity apply equally to an entity that has a net investment in a foreign operation that is a joint venture, an associate or a branch.

B5. This Appendix provides guidance on:

(a) Identifying the foreign currency risks that qualify as a hedged risk in the hedge of a net investment in a foreign operation, given that an entity with many foreign operations may be exposed to a number of foreign currency risks. It specifically addresses:

(i) Whether the controlling entity may designate as a hedged risk only the foreign exchange differences arising from a difference between the functional currencies of the controlling entity and its foreign operation, or whether it may also designate as the hedged risk the foreign exchange differences arising from the difference between the presentation currency of the controlling entity's consolidated financial statements and the functional currency of the foreign operation; and

(ii) If the controlling entity holds the foreign operation indirectly, whether the hedged risk may include only the foreign exchange differences arising from differences in functional currencies between the foreign operation and its immediate controlling entity, or whether the hedged risk may also include any foreign exchange differences between the functional currency of the foreign operation and any intermediate or ultimate controlling entity (i.e., whether the fact that the net investment in the foreign operation is held through an intermediate controlling entity affects the economic risk to the ultimate controlling entity).

(b) Where in an economic entity the hedging instrument can be held. It specifically addresses:

(i) PBE IPSAS 41 allows an entity to designate either a derivative or a non-derivative financial instrument (or a combination of derivative and non-derivative financial instruments) as hedging instruments for foreign currency risk. This appendix addresses whether the nature of the hedging instrument (derivative or non-derivative) or the method of consolidation affects the assessment of hedge effectiveness.

(ii) This appendix also addresses where, within an economic entity, hedging instruments that are hedges of a net investment in a foreign operation can be held to qualify for hedge accounting i.e., whether a qualifying hedge accounting relationship can be established only if the entity hedging its net investment is a party to the hedging instrument or whether any entity within the economic entity, regardless of its functional currency, can hold the hedging instrument.

(c) What amounts should be reclassified from net assets/equity to surplus or deficit as reclassification adjustments on disposal of the foreign operation:

(i) When a foreign operation that was hedged is disposed of, what amounts from the controlling entity's foreign currency translation reserve in respect of the hedging instrument and of that foreign operation should be reclassified from net assets/equity to surplus or deficit in the controlling entity's consolidated financial statements; and

(ii) Whether the method of consolidation affects the determination of the amounts to be reclassified from net assets/equity to surplus or deficit.

Application of PBE IPSAS 41 to Hedges of a Net Investment in a Foreign Operation

Nature of the Hedged Risk and Amount of the Hedged Item for which a Hedging Relationship may be Designated

B6. Hedge accounting may be applied only to the foreign exchange differences arising between the functional currency of the foreign operation and the controlling entity's functional currency.

B7. In a hedge of the foreign currency risks arising from a net investment in a foreign operation, the hedged item can be an amount of net assets equal to or less than the carrying amount of the net assets of the foreign operation in the consolidated financial statements of the controlling entity. The carrying amount of the net assets of a foreign operation that may be designated as the hedged item in the consolidated financial statements of a controlling entity depends on whether any lower level controlling entity of the foreign operation has applied hedge accounting for all or part of the net assets of that foreign operation and that accounting has been maintained in the controlling entity's consolidated financial statements.

B8. The hedged risk may be designated as the foreign currency exposure arising between the functional currency of the foreign operation and the functional currency of any controlling entity (the immediate, intermediate or ultimate controlling entity) of that foreign operation. The fact that the net investment is held through an intermediate controlling entity does not affect the nature of the economic risk arising from the foreign currency exposure to the ultimate controlling entity.

B9. An exposure to foreign currency risk arising from a net investment in a foreign operation may qualify for hedge accounting only once in the consolidated financial statements. Therefore, if the same net assets of a foreign operation are hedged by more than one controlling entity within the economic entity (e,g., both a direct and an indirect controlling entity) for the same risk, only one hedging relationship will qualify for hedge accounting in the consolidated financial statements of the ultimate controlling entity. A hedging relationship designated by one controlling entity in its consolidated financial statements need not be maintained by another higher level controlling entity. However, if it is not maintained by the higher level controlling entity, the hedge accounting applied by the lower level controlling entity must be reversed before the higher level controlling entity's hedge accounting is recognised.

Where the Hedging Instrument can be Held

B10. A derivative or a non-derivative instrument (or a combination of derivative and non-derivative instruments) may be designated as a hedging instrument in a hedge of a net investment in a foreign operation. The hedging instrument(s) may be held by any entity or entities within the economic entity, as long as the designation, documentation and effectiveness requirements of PBE IPSAS 41 paragraph 129 that relate to a net investment hedge are satisfied. In particular, the hedging strategy of the economic entity should be clearly documented because of the possibility of different designations at different levels of the economic entity.

B11. For the purpose of assessing effectiveness, the change in value of the hedging instrument in respect of foreign exchange risk is computed by reference to the functional currency of the controlling entity against whose functional currency the hedged risk is measured, in accordance with the hedge accounting documentation. Depending on where the hedging instrument is held, in the absence of hedge accounting the total change in value might be recognised in surplus or deficit, in other comprehensive revenue and expense, or both. However, the assessment of effectiveness is not affected by whether the change in value of the hedging instrument is recognised in surplus or deficit or in other comprehensive revenue and expense. As part of the application of hedge accounting, the total effective portion of the change is included in other comprehensive revenue and expense. The assessment of effectiveness is not affected by whether the hedging instrument is a derivative or a non-derivative instrument or by the method of consolidation.

Disposal of a Hedged Foreign Operation

B12. When a foreign operation that was hedged is disposed of, the amount reclassified to surplus or deficit as a reclassification adjustment from the foreign currency translation reserve in the consolidated financial statements of the controlling entity in respect of the hedging instrument is the amount that PBE IPSAS 41 paragraph 143 requires to be identified. That amount is the cumulative gain or loss on the hedging instrument that was determined to be an effective hedge.

B13. The amount reclassified to surplus or deficit from the foreign currency translation reserve in the consolidated financial statements of a controlling entity in respect of the net investment in that foreign operation in accordance with PBE IPSAS 4 paragraph 57 is the amount included in that controlling entity's foreign currency translation reserve in respect of that foreign operation. In the ultimate controlling entity's consolidated financial statements, the aggregate net amount recognised in the foreign currency translation reserve in respect of all foreign operations is not affected by the consolidation method. However, whether the ultimate controlling entity uses the direct or the step-by-step method of consolidation, may affect the amount included in its foreign currency translation reserve in respect of an individual foreign operation.

B14. The direct method is the method of consolidation in which the financial statements of the foreign operation are translated directly into the functional currency of the ultimate controlling entity. The step-by-step method is the method of consolidation in which the financial statements of the foreign operation are first translated into the functional currency of any intermediate controlling entity(ies) and then translated into the functional currency of the ultimate controlling entity (or the presentation currency if different).

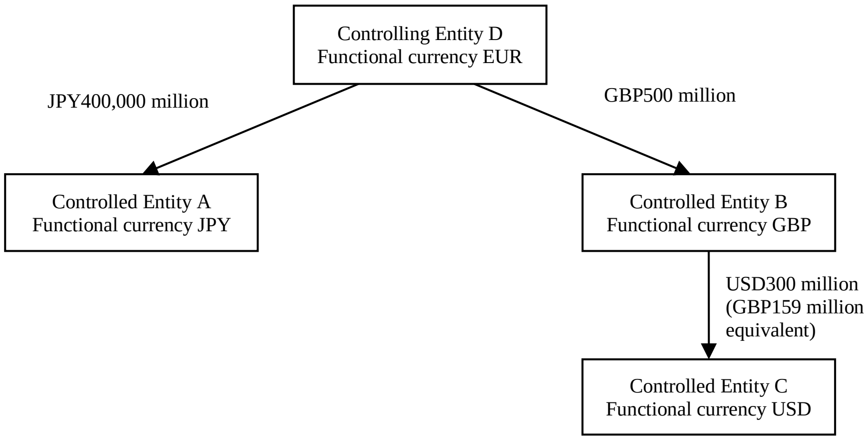
B15. The use of the step-by-step method of consolidation may result in the reclassification to surplus or deficit of an amount different from that used to determine hedge effectiveness. This difference may be eliminated by determining the amount relating to that foreign operation that would have arisen if the direct method of consolidation had been used. Making this adjustment is not required by PBE IPSAS 4. However, it is an accounting policy choice that should be followed consistently for all net investments.

Example

B16. The following example illustrates the application of the preceding paragraphs using the entity structure illustrated below. In all cases the hedging relationships described would be tested for effectiveness in accordance with PBE IPSAS 41, although this testing is not discussed. Controlling Entity D, being the ultimate controlling entity, presents its consolidated financial statements in its functional currency of euro (EUR). Each of the controlled entities i.e., Controlled Entity A, Controlled Entity B and Controlled Entity C, is wholly owned. Controlling Entity D's £500 million net investment in Controlled Entity B (functional currency pounds sterling (GBP)) includes the £159 million equivalent of Controlled Entity B's US$300 million net investment in Controlled Entity C (functional currency US dollars (USD)). In other words, Controlled Entity B's net assets other than its investment in Controlled Entity C are £341 million.

Nature of Hedged Risk for which a Hedging Relationship may be Designated (paragraphs B6–B9)

B17. Controlling Entity D can hedge its net investment in each of Controlled Entities A, B and C for the foreign exchange risk between their respective functional currencies (Japanese yen (JPY), pounds sterling and US dollars) and euro. In addition, Controlling Entity D can hedge the USD/GBP foreign exchange risk between the functional currencies of Controlled Entity B and Controlled Entity C. In its consolidated financial statements, Controlled Entity B can hedge its net investment in Controlled Entity C for the foreign exchange risk between their functional currencies of US dollars and pounds sterling. In the following examples the designated risk is the spot foreign exchange risk because the hedging instruments are not derivatives. If the hedging instruments were forward contracts, Controlling Entity D could designate the forward foreign exchange risk.



Amount of Hedged Item for which a Hedging Relationship may be Designated (paragraphs B6–B9)

B18. Controlling Entity D wishes to hedge the foreign exchange risk from its net investment in Controlled Entity C. Assume that Controlled Entity A has an external borrowing of US$300 million. The net assets of Controlled Entity A at the start of the reporting period are ¥400,000 million including the proceeds of the external borrowing of US$300 million.

B19. The hedged item can be an amount of net assets equal to or less than the carrying amount of Controlling Entity D's net investment in Controlled Entity C (US$300 million) in its consolidated financial statements. In its consolidated financial statements Controlling Entity D can designate the US$300 million external borrowing in Controlled Entity A as a hedge of the EUR/USD spot foreign exchange risk associated with its net investment in the US$300 million net assets of Controlled Entity C. In this case, both the EUR/USD foreign exchange difference on the US$300 million external borrowing in Controlled Entity A and the EUR/USD foreign exchange difference on the US$300 million net investment in Controlled Entity C are included in the foreign currency translation reserve in Controlling Entity D's consolidated financial statements after the application of hedge accounting.

B20. In the absence of hedge accounting, the total USD/EUR foreign exchange difference on the US$300 million external borrowing in Controlled Entity A would be recognised in Controlling Entity D's consolidated financial statements as follows:

- USD/JPY spot foreign exchange rate change, translated to euro, in surplus or deficit; and
- JPY/EUR spot foreign exchange rate change in other comprehensive revenue and expense.

Instead of the designation in paragraph B19, in its consolidated financial statements Controlling Entity D can designate the US$300 million external borrowing in Controlled Entity A as a hedge of the GBP/USD spot foreign exchange risk between Controlled Entity C and Controlled Entity B. In this case, the total USD/EUR foreign exchange difference on the US$300 million external borrowing in Controlled Entity A would instead be recognised in Controlling Entity D's consolidated financial statements as follows:

- The GBP/USD spot foreign exchange rate change in the foreign currency translation reserve relating to Controlled Entity C,
- GBP/JPY spot foreign exchange rate change, translated to euro, in surplus or deficit; and
- JPY/EUR spot foreign exchange rate change in other comprehensive revenue and expense.

B21. Controlling Entity D cannot designate the US$300 million external borrowing in Controlled Entity A as a hedge of both the EUR/USD spot foreign exchange risk and the GBP/USD spot foreign exchange risk in its consolidated financial statements. A single hedging instrument can hedge the same designated risk only once. Controlled Entity B cannot apply hedge accounting in its consolidated financial statements because the hedging instrument is held outside the economic entity comprising Controlled Entity B and Controlled Entity C.

Where in an Economic Entity can the Hedging Instrument be Held (paragraphs B10 and B11)?

B22. As noted in paragraph B20, the total change in value in respect of foreign exchange risk of the US$300 million external borrowing in Controlled Entity A would be recorded in both surplus or deficit (USD/JPY spot risk) and other comprehensive revenue and expense (EUR/JPY spot risk) in Controlling Entity D's consolidated financial statements in the absence of hedge accounting. Both amounts are included for the purpose of assessing the effectiveness of the hedge designated in paragraph B19 because the change in value of both the hedging instrument and the hedged item are computed by reference to the euro functional currency of Controlling Entity D against the US dollar functional currency of Controlled Entity C, in accordance with the hedge documentation. The method of consolidation (i.e., direct method or step-by-step method) does not affect the assessment of the effectiveness of the hedge.

Amounts Reclassified to Surplus or Deficit on Disposal of a Foreign Operation (paragraphs B12 and B13)

B23. When Controlled Entity C is disposed of, the amounts reclassified to surplus or deficit in Controlling Entity D's consolidated financial statements from its foreign currency translation reserve (FCTR) are:

(a) In respect of the US$300 million external borrowing of Controlled Entity A, the amount that PBE IPSAS 41 requires to be identified, i.e., the total change in value in respect of foreign exchange risk that was recognised in other comprehensive revenue and expense as the effective portion of the hedge; and

(b) In respect of the US$300 million net investment in Controlled Entity C, the amount determined by the entity's consolidation method. If Controlling Entity D uses the direct method, its FCTR in respect of Controlled Entity C will be determined directly by the EUR/USD foreign exchange rate. If Controlling Entity D uses the step-by-step method, its FCTR in respect of Controlled Entity C will be determined by the FCTR recognised by Controlled Entity B reflecting the GBP/USD foreign exchange rate, translated to Controlling Entity D's functional currency using the EUR/GBP foreign exchange rate. Controlling Entity D's use of the step-by-step method of consolidation in prior periods does not require it to or preclude it from determining the amount of FCTR to be reclassified when it disposes of Controlled Entity C to be the amount that it would have recognised if it had always used the direct method, depending on its accounting policy.

Hedging More than One Foreign Operation (paragraphs B7, B9 and B11)

B24. The following examples illustrate that in the consolidated financial statements of Controlling Entity D, the risk that can be hedged is always the risk between its functional currency (euro) and the functional currencies of Controlled Entities B and C. No matter how the hedges are designated, the maximum amounts that can be effective hedges to be included in the foreign currency translation reserve in Controlling Entity D's consolidated financial statements when both foreign operations are hedged are US$300 million for EUR/USD risk and £341 million for EUR/GBP risk. Other changes in value due to changes in foreign exchange rates are included in Controlling Entity D's consolidated surplus or deficit. Of course, it would be possible for Controlling Entity D to designate US$300 million only for changes in the USD/GBP spot foreign exchange rate or £500 million only for changes in the GBP/EUR spot foreign exchange rate.

Entity D Holds Both USD and GBP Hedging Instruments

B25. Controlling Entity D may wish to hedge the foreign exchange risk in relation to its net investment in Controlled Entity B as well as that in relation to Controlled Entity C. Assume that Controlling Entity D holds suitable hedging instruments denominated in US dollars and pounds sterling that it could designate as hedges of its net investments in Controlled Entity B and Controlled Entity C. The designations Controlling Entity D can make in its consolidated financial statements include, but are not limited to, the following:

(a) US$300 million hedging instrument designated as a hedge of the US$300 million of net investment in Controlled Entity C with the risk being the spot foreign exchange exposure (EUR/USD) between Controlling Entity D and Controlled Entity C and up to £341 million hedging instrument designated as a hedge of £341 million of the net investment in Controlled Entity B with the risk being the spot foreign exchange exposure (EUR/GBP) between Controlling Entity D and Controlled Entity B.

(b) US$300 million hedging instrument designated as a hedge of the US$300 million of net investment in Controlled Entity C with the risk being the spot foreign exchange exposure (GBP/USD) between Controlled Entity B and Controlled Entity C and up to £500 million hedging instrument designated as a hedge of £500 million of the net investment in Controlled Entity B with the risk being the spot foreign exchange exposure (EUR/GBP) between Controlling Entity D and Controlled Entity B.

B26. The EUR/USD risk from Controlling Entity D's net investment in Controlled Entity C is a different risk from the EUR/GBP risk from Controlling Entity D's net investment in Controlled Entity B. However, in the case described in paragraph B25(a), by its designation of the USD hedging instrument it holds, Controlling Entity D has already fully hedged the EUR/USD risk from its net investment in Controlled Entity C. If Controlling Entity D also designated a GBP instrument it holds as a hedge of its £500 million net investment in Controlled Entity B, £159 million of that net investment, representing the GBP equivalent of its USD net investment in Controlled Entity C, would be hedged twice for GBP/EUR risk in Controlling Entity D's consolidated financial statements.

B27. In the case described in paragraph B25(b), if Controlling Entity D designates the hedged risk as the spot foreign exchange exposure (GBP/USD) between Controlled Entity B and Controlled Entity C, only the GBP/USD part of the change in the value of its US$300 million hedging instrument is included in Controlling Entity D's foreign currency translation reserve relating to Controlled Entity C. The remainder of the change (equivalent to the GBP/EUR change on £159 million) is included in Controlling Entity D's consolidated surplus or deficit, as in paragraph B20. Because the designation of the USD/GBP risk between Controlled Entities B and C does not include the GBP/EUR risk, Controlling Entity D is also able to designate up to £500 million of its net investment in Controlled Entity B with the risk being the spot foreign exchange exposure (GBP/EUR) between Controlling Entity D and Controlled Entity B.

Entity B Holds the USD Hedging Instrument

B28. Assume that Controlled Entity B holds US$300 million of external debt the proceeds of which were transferred to Controlling Entity D by an inter-entity loan denominated in pounds sterling. Because both its assets and liabilities increased by £159 million, Controlled Entity B's net assets are unchanged. Controlled Entity B could designate the external debt as a hedge of the GBP/USD risk of its net investment in Controlled Entity C in its consolidated financial statements. Controlling Entity D could maintain Controlled Entity B's designation of that hedging instrument as a hedge of its US$300 million net investment in Controlled Entity C for the GBP/USD risk (see paragraph B9) and Controlling Entity D could designate the GBP hedging instrument it holds as a hedge of its entire £500 million net investment in Controlled Entity B. The first hedge, designated by Controlled Entity B, would be assessed by reference to Controlled Entity B's functional currency (pounds sterling) and the second hedge, designated by Controlling Entity D, would be assessed by reference to Controlling Entity D's functional currency (euro). In this case, only the GBP/USD risk from Controlling Entity D's net investment in Controlled Entity C has been hedged in Controlling Entity D's consolidated financial statements by the USD hedging instrument, not the entire EUR/USD risk. Therefore, the entire EUR/GBP risk from Controlling Entity D's £500 million net investment in Controlled Entity B may be hedged in the consolidated financial statements of Controlling Entity D.

B29. However, the accounting for Controlling Entity D's £159 million loan payable to Controlled Entity B must also be considered. If Controlling Entity D's loan payable is not considered part of its net investment in Controlled Entity B because it does not satisfy the conditions in PBE 1PSAS 4 paragraph 18, the GBP/EUR foreign exchange difference arising on translating it would be included in Controlling Entity D's consolidated surplus or deficit. If the £159 million loan payable to Controlled Entity B is considered part of Controlling Entity D's net investment, that net investment would be only £341 million and the amount Controlling Entity D could designate as the hedged item for GBP/EUR risk would be reduced from £500 million to £341 million accordingly.

B30. If Controlling Entity D reversed the hedging relationship designated by Controlled Entity B, Controlling Entity D could designate the US$300 million external borrowing held by Controlled Entity B as a hedge of its US$300 million net investment in Controlled Entity C for the EUR/USD risk and designate the GBP hedging instrument it holds itself as a hedge of only up to £341 million of the net investment in Controlled Entity B. In this case the effectiveness of both hedges would be computed by reference to Controlling Entity D's functional currency (euro). Consequently, both the USD/GBP change in value of the external borrowing held by Controlled Entity B and the GBP/EUR change in value of Controlling Entity D's loan payable to Controlled Entity B (equivalent to USD/EUR in total) would be included in the foreign currency translation reserve in Controlling Entity D's consolidated financial statements. Because Controlling Entity D has already fully hedged the EUR/USD risk from its net investment in Controlled Entity C, it can hedge only up to £341 million for the EUR/GBP risk of its net investment in Controlled Entity B.

Appendix C: Extinguishing Financial Liabilities with Equity Instruments

This Appendix is an integral part of PBE IPSAS 41.

Introduction

C1. A debtor and creditor might renegotiate the terms of a financial liability with the result that the debtor extinguishes the liability fully or partially by issuing equity instruments to the creditor. These transactions are sometimes referred to as 'debt for equity swaps'.

Scope

C2. This Appendix addresses the accounting by an entity when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to a creditor of the entity to extinguish all or part of the financial liability. It does not address the accounting by the creditor.

C3. An entity shall not apply this Appendix to transactions in situations where:

(a) The creditor is also a direct or indirect shareholder and is acting in its capacity as a direct or indirect existing shareholder.

(b) The creditor and the entity are controlled by the same party or parties before and after the transaction and the substance of the transaction includes an equity distribution by, or contribution to, the entity.

(c) Extinguishing the financial liability by issuing equity shares is in accordance with the original terms of the financial liability.

C4. This Appendix addresses the following issues:

(a) Are an entity's equity instruments issued to extinguish all or part of a financial liability 'consideration paid' in accordance with paragraph 37 of PBE IPSAS 41 *Financial Instruments*?

(b) How should an entity initially measure the equity instruments issued to extinguish such a financial liability?

(c) How should an entity account for any difference between the carrying amount of the financial liability extinguished and the initial measurement amount of the equity instruments issued?

Consensus

C5. The issue of an entity's equity instruments to a creditor to extinguish all or part of a financial liability is consideration paid in accordance with paragraph 37 of PBE IPSAS 41. An entity shall remove a financial liability (or part of a financial liability) from its statement of financial position when, and only when, it is extinguished in accordance with paragraph 35 of PBE IPSAS 41.

C6. When equity instruments issued to a creditor to extinguish all or part of a financial liability are recognised initially, an entity shall measure them at the fair value of the equity instruments issued, unless that fair value cannot be reliably measured.

C7. If the fair value of the equity instruments issued cannot be reliably measured then the equity instruments shall be measured to reflect the fair value of the financial liability extinguished. In measuring the fair value of a financial liability extinguished that includes a demand feature (e.g., a demand deposit), paragraph 68 of PBE IPSAS 41 is not applied.

C8. If only part of the financial liability is extinguished, the entity shall assess whether some of the consideration paid relates to a modification of the terms of the liability that remains outstanding. If part of the consideration paid does relate to a modification of the terms of the remaining part of the liability, the entity shall allocate the consideration paid between the part of the liability extinguished and the part of the liability that remains outstanding. The entity shall consider all relevant facts and circumstances relating to the transaction in making this allocation.

C9. The difference between the carrying amount of the financial liability (or part of a financial liability) extinguished, and the consideration paid, shall be recognised in surplus or deficit, in accordance with paragraph 37 of PBE IPSAS 41. The equity instruments issued shall be recognised initially and measured at the date the financial liability (or part of that liability) is extinguished.

C10. When only part of the financial liability is extinguished, consideration shall be allocated in accordance with paragraph C8. The consideration allocated to the remaining liability shall form part of the assessment of whether the terms of that remaining liability have been substantially modified. If the remaining liability has been substantially modified, the entity shall account for the modification as the extinguishment of the original liability and the recognition of a new liability as required by paragraph 36 of PBE IPSAS 41.

C11. An entity shall disclose a gain or loss recognised in accordance with paragraphs C9 and C10 as a separate line item in surplus or deficit or in the notes.

Appendix D

Amendments to Other Standards

PBE IPSAS 41 amends the following standards:

- PBE IPSAS 1 *Presentation of Financial Reports*
- PBE IPSAS 4 *The Effects of Changes in Foreign Exchange Rates*
- PBE IPSAS 5 *Borrowing Costs*
- PBE IPSAS 9 *Revenue from Exchange Transactions*
- PBE IPSAS 12 *Inventories*
- PBE IPSAS 13 *Leases*
- PBE IPSAS 14 *Events After the Reporting Date*
- PBE IPSAS 16 *Investment Property*
- PBE IPSAS 17 *Property, Plant and Equipment*
- PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*
- PBE IPSAS 21 *Impairment of Non-Cash-Generating Assets*
- PBE IPSAS 23 *Revenue from Non-Exchange Transactions*
- PBE IPSAS 26 *Impairment of Cash-Generating Assets*
- PBE IPSAS 28 *Financial Instruments: Presentation*
- PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*
- PBE IPSAS 30 *Financial Instruments: Disclosures*
- PBE IPSAS 31 *Intangible Assets*
- PBE IPSAS 32 *Service Concession Arrangements: Grantor*
- PBE IPSAS 34 *Separate Financial Statements*
- PBE IPSAS 35 *Consolidated Financial Statements*
- PBE IPSAS 36 *Investments in Associates and Joint Ventures*
- PBE IPSAS 37 *Joint Arrangements*
- PBE IPSAS 38 *Disclosure of Interests in Other Entities*
- PBE IFRS 3 *Business Combinations*
- PBE IFRS 4 *Insurance Contracts*
- PBE IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*
- PBE IAS 12 *Income Taxes*
- PBE IAS 34 *Interim Financial Reporting*
- PBE FRS 45 *Service Concession Arrangements: Operator*
- PBE FRS 47 *First-time Adoption of PBE Standards by Entities Other Than Those Previously Applying NZ IFRS*
- XRB A1 *Application of the Accounting Standards Framework*
- PBE SFR–A (NFP) *Public Benefit Entity Simple Format Reporting–Accrual (Not-For-Profit)*
- PBE SFR–A (PS) *Public Benefit Entity Simple Format Reporting–Accrual (Public Sector)*

Appendix D

Amendments to Other Standards

Except where otherwise stated, an entity shall apply the amendments in this Appendix when it applies PBE IPSAS 41 *Financial Instruments* issued in March 2019.

PBE IPSAS 1 *Presentation of Financial Reports*

In paragraph 7, the definition of 'other comprehensive revenue and expense' and paragraphs 79, 82, 99.1, 103.5, 103.7, 103.8, 138 and 154.7 are amended.
A reference to paragraphs 125A–125C of IPSAS 41 (which are not used in this Standard) is added.
Paragraph 154.12 is added. New text is underlined and deleted text is struck through.

7. **The following terms are used in this Standard with the meanings specified:**

...

Other comprehensive revenue and expense comprises items of revenue and expense (including reclassification adjustments) that are not recognised in surplus or deficit as required or permitted by other PBE Standards.

The components of other comprehensive revenue and expense include:

(a) ...

(d) Gains and losses from investments in equity instruments designated at fair value through other comprehensive revenue and expense in accordance with paragraph 106 of PBE IPSAS 41 *Financial Instruments* ~~on remeasuring available-for-sale financial assets (see PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*~~); and

(e) Gains and losses on financial assets measured at fair value through other comprehensive revenue and expense in accordance with paragraph 41 of PBE IPSAS 41;

(~~e~~f) The effective portion of gains and losses on hedging instruments in a cash flow hedge ~~(see PBE IPSAS 29)~~ and the gains and losses on hedging instruments that hedge investments in equity instruments measured at fair value through other comprehensive revenue and expense in accordance with paragraph 106 of PBE IPSAS 41 (see paragraphs 113–155 of PBE IPSAS 41);

(g) For particular liabilities designated as at fair value through surplus or deficit, the amount of the change in fair value that is attributable to changes in the liability's credit risk (see paragraph 108 of PBE IPSAS 41);

(h) Changes in the value of the time value of options when separating the intrinsic value and time value of an option contract and designating as the hedging instrument only the changes in the intrinsic value (see paragraphs 113–155 of PBE IPSAS 41); and

(i) Changes in the value of the forward elements of forward contracts when separating the forward element and spot element of a forward contract and designating as the hedging instrument only the changes in the spot element, and changes in the value of the foreign currency basis spread of a financial instrument when excluding it from the designation of that financial instrument as the hedging instrument (see paragraphs 113–155 of PBE IPSAS 41).

…

79. Current assets include assets (such as taxes receivable, user charges receivable, fines and regulatory fees receivable, members' fees receivable, contract grants receivable, prepayments, inventories and accrued investment revenue) that are either realised, consumed or sold, as part of the normal operating cycle even when they are not expected to be realised within twelve months after the reporting date. Current assets also include assets held primarily for the purpose of trading (examples include some financial assets that meet

the definition of ~~classified as~~ held for trading in ~~accordance with~~ PBE IPSAS 41 ~~PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*~~) and the current portion of non-current financial assets.

…

82. Other current liabilities are not settled as part of the normal operating cycle, but are due for settlement within twelve months after the reporting date or held primarily for the purpose of being traded. Examples are some financial liabilities that meet the definition of ~~classified as~~ held for trading in ~~accordance with~~ PBE IPSAS 41 ~~PBE IPSAS 29~~, bank overdrafts, and the current portion of non-current financial liabilities, dividends or similar distributions payable, income taxes and other non-trade payables. Financial liabilities that provide financing on a long-term basis (i.e., are not part of the working capital used in the entity's normal operating cycle) and are not due for settlement within twelve months after the reporting date are non-current liabilities, subject to paragraphs 85 and 86.

…

99.1 The surplus or deficit section of the statement of comprehensive revenue and expense shall include line items that present the following amounts for the period:

(a) Revenue, presenting separately interest revenue calculated using the effective interest method;

(aa) Gains and losses arising from the derecognition of financial assets measured at amortised cost;

(b) Finance costs;

(ba) Impairment losses (including reversals of impairment losses or impairment gains) determined in accordance with paragraphs 73–93 of PBE IPSAS 41;

(c) Share of the surplus or deficit of associates and joint ventures accounted for using the equity method;

(ca) If a financial asset is reclassified out of the amortised cost measurement category so that it is measured at fair value through surplus or deficit, any gain or loss arising from a difference between the previous amortised cost of the financial asset and its fair value at the reclassification date (as defined in PBE IPSAS 41);

(cb) If a financial asset is reclassified out of the fair value through other comprehensive revenue and expense measurement category so that it is measured at fair value through surplus or deficit, any cumulative gain or loss previously recognised in other comprehensive revenue and expense that is reclassified to surplus or deficit;

…

103.5 Other PBE Standards specify whether and when amounts previously recognised in other comprehensive revenue and expense are reclassified to surplus or deficit. Such reclassifications are referred to in this Standard as reclassification adjustments. A reclassification adjustment is included with the related component of other comprehensive revenue and expense in the period that the adjustment is reclassified to surplus or deficit. ~~For example, gains realised on the disposal of available-for-sale financial assets are included in surplus or deficit of the current period.~~ These amounts may have been recognised in other comprehensive revenue and expense as unrealised gains in the current or previous periods. Those unrealised gains must be deducted from other comprehensive revenue and expense in the period in which the realised gains are reclassified to surplus or deficit to avoid including them in total comprehensive revenue and expense twice.

…

103.7 Reclassification adjustments arise, for example, on disposal of a foreign operation (see PBE IPSAS 4)~~, on derecognition of available-for-sale financial assets (see PBE IPSAS 29)~~ and when some ~~a~~ hedged forecast cash flows ~~transaction~~ affect~~s~~ surplus or deficit (see ~~paragraph 111 of PBE IPSAS 29~~ paragraph 140(d) of PBE IPSAS 41 in relation to cash flow hedges).

103.8 Reclassification adjustments do not arise on changes in revaluation surplus recognised in accordance with PBE IPSAS 17 or PBE IPSAS 31 or on remeasurements of defined benefit plans recognised in accordance with PBE IPSAS 39. These components are recognised in other comprehensive revenue and expense and are not reclassified to surplus or deficit in subsequent periods. Changes in revaluation surplus may be transferred to accumulated comprehensive revenue and expense in subsequent periods as the asset is used or when it is derecognised (see PBE IPSAS 17 and PBE IPSAS 31). In accordance with PBE IPSAS 41, reclassification adjustments do not arise if a cash flow hedge or the accounting for the time value of an option (or the forward element of a forward contract or the foreign currency basis spread of a financial instrument) result in amounts that are removed from the cash flow hedge reserve or a separate component of net assets/equity, respectively, and included directly in the initial cost or other carrying amount of an asset or a liability. These amounts are directly transferred to assets or liabilities.

…

125A–125C [Not used]

…

138. In the process of applying the entity's accounting policies, management makes various judgements, apart from those involving estimations, that can significantly affect the amounts recognised in the financial statements. For example, management makes judgements in determining:

(a) Whether assets are investment properties;

(b) Whether agreements for the provision of goods and/or services that involve the use of dedicated assets are leases;

(c) Whether, in substance, particular sales of goods are financing arrangements and therefore do not give rise to revenue; ~~and~~

(d) Whether the substance of the relationship between the reporting entity and other entities indicates that these other entities are controlled by the reporting entity~~.~~ and;

(e) Whether the contractual terms of a financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

…

154.7 **PBE IFRS 9 *Financial Instruments*, issued in January 2017, amended paragraphs 7, 79, 82, 99.1, 103.5, 103.7 and 103.8. An entity shall apply those amendments when it applies PBE IFRS 9.*~~.~~**

* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.

…

154.12 **PBE IPSAS 41, issued in March 2019, amended paragraphs 7, 79, 82, 99.1, 103.5, 103.7, 103.8, 138 and 154.7. An entity shall apply those amendments when it applies PBE IPSAS 41.**

PBE IPSAS 4 *The Effects of Changes in Foreign Exchange Rates*

Paragraphs 3, 4, 5, 31, 58, 61 and 72.3 are amended. Paragraph 72.6 is added. New text is underlined and deleted text is struck through.

3. **An entity that prepares and presents financial statements shall apply this Standard:**

(a) **In accounting for transactions and balances in foreign currencies, except for those derivative transactions and balances that are within the scope of PBE IPSAS 41 *Financial Instruments* ~~PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*~~;**

...

4. PBE IPSAS 41 ~~PBE IPSAS 29~~ applies to many foreign currency derivatives and, accordingly, these are excluded from the scope of this Standard. However, those foreign currency derivatives that are not within the scope of PBE IPSAS 41 ~~PBE IPSAS 29~~ (e.g., some foreign currency derivatives that are embedded in other contracts) are within the scope of this Standard. In addition, this Standard applies when an entity translates amounts relating to derivatives from its functional currency to its presentation currency.

5. This Standard does not apply to hedge accounting for foreign currency items, including the hedging of a net investment in a foreign operation. PBE IPSAS 41 ~~PBE IPSAS 29~~ applies to hedge accounting.

…

31. As noted in paragraph 5, this Standard does not deal with hedge accounting for foreign currency items. Guidance in relation to hedge accounting, including the criteria for when to use hedge accounting, can be found in PBE IPSAS 41~~PBE IPSAS 29~~.

…

58. An entity may dispose or partially dispose of its interest in a foreign operation through sale, liquidation, repayment of contributed capital, or abandonment of all or part of that entity. ~~The payment of a dividend or similar distribution is part of a disposal only when it constitutes a return of the investment, for example when the dividend or similar distribution is paid out of pre-acquisition surplus.~~ A writedown of the carrying amount of a foreign operation, either because of its own losses or because of an impairment recognised by the entity holding the interest, does not constitute a partial disposal. Accordingly, no part of the deferred foreign exchange gain or loss is recognised in surplus or deficit at the time of a writedown.

…

61. **The entity shall disclose:**

   (a) **The amount of exchange differences recognised in surplus or deficit, except for those arising on financial instruments measured at fair value through surplus or deficit in accordance with PBE IPSAS 41 ~~PBE IPSAS 29~~; and**

…

72.3 **PBE IFRS 9 *Financial Instruments*, issued in January 2017, amended paragraphs 3, 4, 5, 31 and 61. An entity shall apply those amendments when it applies PBE IFRS 9.***

* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.

…

72.6 **PBE IPSAS 41, issued in March 2019, amended paragraphs 3, 4, 5, 31, 58, 61 and 72.3. An entity shall apply those amendments when it applies PBE IPSAS 41.**

PBE IPSAS 5 *Borrowing Costs*

Paragraphs 6 and 43.3 are amended. Paragraph 43.5 is added. New text is underlined and deleted text is struck through.

6. Borrowing costs may include:

   (a) ~~Interest on bank overdrafts and short-term and long-term borrowings~~ Interest expense calculated using the effective interest method as described in PBE IPSAS 41 *Financial Instruments*;

   (b)–(c) [Deleted by IPSASB]

   ~~(b) Amortisation of discounts or premiums relating to borrowings;~~

   ~~(c) Amortisation of ancillary costs incurred in connection with the arrangement of borrowings;~~

   (d) Finance charges in respect of finance leases and service concession arrangements; and

   (e) Exchange differences arising from foreign currency borrowings, to the extent that they are regarded as an adjustment to interest costs.

...

43.3 **PBE IFRS 9 *Financial Instruments*, issued in January 2017, amended paragraph 6. An entity shall apply that amendment when it applies PBE IFRS 9.***

* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.

…

43.5 **PBE IPSAS 41, issued in March 2019, amended paragraphs 6 and 43.3. An entity shall apply those amendments when it applies PBE IPSAS 41.**

PBE IPSAS 9 *Revenue from Exchange Transactions*

Paragraphs 1, 9, 10, 16, 33, 39 and 42.4 are amended. Paragraph 42.5 is added. Paragraphs 34–36 are deleted. New text is underlined and deleted text is struck through.

Scope

1. **An entity that prepares and presents financial statements shall apply this Standard in accounting for revenue arising from the following exchange transactions and events:**

   (a) **The rendering of services;**

   (b) **The sale of goods; and**

   (c) **The use by others of entity assets yielding ~~interest,~~ royalties~~, and dividends or similar distributions~~.**

…

9. The use by others of entity assets gives rise to revenue in the form of:

   (a) Interest – charges for the use of cash or cash equivalents, or amounts due to the entity;

   (b) Royalties – charges for the use of long-term assets of the entity, for example, patents, trademarks, copyrights, and computer software; and

   (c) Dividends or similar distributions – distributions of surpluses to holders of equity investments in proportion to their holdings of a particular class of capital.

   Interest and dividends or similar distributions are accounted for in accordance with PBE IPSAS 41 *Financial Instruments*.

10. This Standard does not deal with revenues arising from:

   (a) …

   (e) Interest, dividends or similar distributions, or c~~C~~hanges in the fair value of financial assets and financial liabilities or their disposal (see PBE IPSAS 41 *Financial Instruments* ~~guidance on the recognition and measurement of financial instruments can be found in PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*~~);

…

16. In most cases, the consideration is in the form of cash or cash equivalents, and the amount of revenue is the amount of cash or cash equivalents received or receivable. However, when the inflow of cash or cash equivalents is deferred, the fair value of the consideration may be less than the nominal amount of cash received or receivable. For example, an entity may provide interest-free credit to the purchaser or accept a note receivable bearing a below-market interest rate from the purchaser as consideration for the sale of goods. When the arrangement effectively constitutes a financing transaction, the fair value of the consideration is determined by discounting all future receipts using an imputed rate of interest. The imputed rate of interest is the more clearly determinable of either:

   (a) The prevailing rate for a similar instrument of an issuer with a similar credit rating; or

   (b) A rate of interest that discounts the nominal amount of the instrument to the current cash sales price of the goods or services.

   The difference between the fair value and the nominal amount of the consideration is recognised as interest revenue in accordance with PBE IPSAS 41~~paragraphs 33 and 34~~.

…

~~Interest,~~ Royalties~~, and Dividends or Similar Distributions~~

33. **Revenue arising from the use by others of entity assets yielding ~~interest,~~ royalties~~, and dividends or similar distributions~~ shall be recognised as they are earned in accordance with the substance of the relevant agreement. ~~using the accounting treatments set out in paragraph 34 when:~~**

   ~~(a) **It is probable that the economic benefits or service potential associated with the transaction will flow to the entity; and**~~

   ~~(b) **The amount of the revenue can be measured reliably.**~~

34–36 [Deleted by NZASB]

~~34. **Revenue shall be recognised using the following accounting treatments:**~~

~~(a) **Interest shall be recognised on a time proportion basis that takes into account the effective yield on the asset;**~~

~~(b) **Royalties shall be recognised as they are earned in accordance with the substance of the relevant agreement; and**~~

~~(c) **Dividends or similar distributions shall be recognised when the shareholder's or the entity's right to receive payment is established.**~~

~~35. The effective yield on an asset is the rate of interest required to discount the stream of future cash receipts expected over the life of the asset to equate to the initial carrying amount of the asset. Interest revenue includes the amount of amortisation of any discount, premium, or other difference between the initial carrying amount of a debt security and its amount at maturity.~~

~~36. When unpaid interest has accrued before the acquisition of an interest-bearing investment, the subsequent receipt of interest is allocated between pre-acquisition and post-acquisition periods; only the post-acquisition portion is recognised as revenue. When dividends or similar distributions on equity securities are declared from pre-acquisition net surplus, those dividends or similar distributions are deducted from the cost of the securities. If it is difficult to make such an allocation except on an arbitrary basis, dividends or similar distributions are recognised as revenue unless they clearly represent a recovery of part of the cost of the equity securities.~~

…

Disclosure

39. **An entity shall disclose:**

(a) **The accounting policies adopted for the recognition of revenue, including the methods adopted to determine the stage of completion of transactions involving the rendering of services;**

(b) **The amount of each significant category of revenue recognised during the period, including revenue arising from:**

(i) **The rendering of services;**

(ii) **The sale of goods;**

(iii) [Deleted by NZASB] ~~**Interest;**~~

(iv) **Royalties;**

(v) [Deleted by NZASB] ~~**Dividends or similar distributions;**~~

(vi) **Members' fees or subscriptions (exchange component); and**

(c) **The amount of revenue arising from exchanges of goods or services included in each significant category of revenue.**

…

42.4 **PBE IFRS 9 *Financial Instruments*, issued in January 2017, amended paragraph 10. An entity shall apply that amendment when it applies PBE IFRS 9.** *

* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.

42.5 **PBE IPSAS 41, issued in March 2019, amended paragraphs 1, 9, 10, 16, 33, 39 and 42.4 and deleted paragraphs 34-36. An entity shall apply those amendments when it applies PBE IPSAS 41.**

In the non-integral implementation guidance that accompanies PBE IPSAS 9, paragraphs IG1, IG12, IG25 and a heading above paragraph IG29 are amended. New text is underlined and deleted text is struck through.

Implementation Guidance

This guidance accompanies, but is not part of, PBE IPSAS 9.

IG1. Entities derive revenues from exchange or non-exchange transactions. This Standard deals only with revenue arising from exchange transactions including the following~~. Revenue from exchange transactions is derived from~~:

(a) Sale of goods or provision of services to third parties or members of the organisation;

(b) Sale of goods or provision of services to government agencies;

(c) The use by others of entity assets yielding ~~interest,~~ royalties~~, and dividends or similar distributions~~; and

(d) Subscriptions or levies on members of the organisation (excluding any donation element).

…

Financial Service Fees

IG12. The recognition of revenue for financial service fees depends on (a) the purposes for which the fees are assessed, and (b) the basis of accounting for any associated financial instrument. The description of fees for financial services may not be indicative of the nature and substance of the services provided. Therefore, it is necessary to distinguish between fees that are an integral part of the effective interest rate (see PBE IPSAS 41) ~~yield~~ of a financial instrument, fees that are earned as services are provided, and fees that are earned on the execution of a significant act.

(a) [Deleted by NZASB] ~~**Fees that are an integral part of the effective interest rate of a financial instrument**~~

~~Such fees are generally treated as an adjustment to the effective interest rate. However, when the financial instrument is measured at fair value with the change in fair value recognised in surplus or deficit, the fees are recognised as revenue when the instrument is initially recognised.~~

~~(i) *Origination fees received by the entity relating to the creation or acquisition of a financial asset other than one that under PBE IPSAS 29* Financial Instruments: Recognition and Measurement *is classified as a financial asset "at fair value through surplus or deficit"*~~

~~Such fees may include compensation for activities such as evaluating the borrower's financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction. These fees are an integral part of generating an involvement with the resulting financial instrument and, together with the related transaction costs (as defined in PBE IPSAS 29), are deferred and recognised as an adjustment to the effective interest rate.~~

~~(ii) *Commitment fees received by the entity to originate a loan when the loan commitment is outside the scope of PBE IPSAS 29*~~

~~If it is probable that the entity will enter into a specific lending arrangement and the loan commitment is not within the scope of PBE IPSAS 29, the commitment fee received is regarded as compensation for an ongoing involvement with the acquisition of a financial instrument and, together with the related transaction costs (as defined in PBE IPSAS 29), is deferred and recognised as an adjustment to the effective interest rate. If the commitment expires without the entity making the loan, the fee is recognised as revenue on expiry. Loan commitments that are within the scope of PBE IPSAS 29 are accounted for as derivatives and measured at fair value.~~

~~(iii) *Origination fees received on issuing financial liabilities measured at amortised cost*~~

~~These fees are an integral part of generating an involvement with a financial liability. When a financial liability is not classified as "at fair value through surplus or deficit," the origination fees received are included, with the related transaction costs (as defined in PBE IPSAS 29) incurred, in the initial carrying amount of the financial liability and recognised as an adjustment to the effective interest rate. An entity distinguishes fees and costs that are an integral part of the effective interest rate for the financial liability from~~

~~origination fees and transaction costs relating to the right to provide services, such as investment management services.~~

(b) **Fees earned as services are provided**

(i) …

(ii) *Commitment fees to originate a loan when the loan commitment is outside the scope of PBE IPSAS 41 ~~PBE IPSAS 29~~*

If it is unlikely that a specific lending arrangement will be entered into and the loan commitment is outside the scope of PBE IPSAS 41 ~~PBE IPSAS 29~~, the commitment fee is recognised as revenue on a time proportion basis over the commitment period. Loan commitments that are within the scope of PBE IPSAS 41 ~~PBE IPSAS 29~~ are accounted for as derivatives and measured at fair value.

(iii) *Investment management fees*

Fees charged for managing investments are recognised as revenue as the services are provided.

Incremental costs that are directly attributable to securing an investment management contract are recognised as an asset if they can be identified separately and measured reliably and if it is probable that they will be recovered. As in PBE IPSAS 41 ~~PBE IPSAS 29~~, an incremental cost is one that would not have been incurred if the entity had not secured the investment management contract. The asset represents …

…

Sale of Goods

…

Instalment Sales, under Which the Consideration is Receivable in Instalments

IG25. Revenue attributable to the sales price, exclusive of interest, is recognised at the date of sale. The sale price is the present value of the consideration, determined by discounting the instalments receivable at the imputed rate of interest. The interest element is recognised as revenue as it is earned, on a ~~time proportion~~ basis that takes into account the imputed rate of interest in accordance with PBE IPSAS 41.

~~Interest,~~ Royalties~~, and Dividends or Similar Distributions~~

Licence Fees and Royalties

IG29. …

…

Comparison with IPSAS 9

PBE IPSAS 9 *Revenue from Exchange Transactions* is drawn from IPSAS 9 *Revenue from Exchange Transactions.* ~~There are no significant differences between PBE IPSAS 9 and IPSAS 9.~~ The scope of the two standards differ. Revenue from interest and dividends or similar distributions are outside the scope of PBE IPSAS 9, but within the scope of IPSAS 9.

PBE IPSAS 12 *Inventories*

Paragraphs 2 and 52.5 are amended. Paragraph 52.7 is added. New text is underlined and deleted text is struck through.

2. **An entity that prepares and presents financial statements shall apply this Standard in accounting for all inventories except:**

   (a) …

   (b) **Financial instruments (see PBE IPSAS 28 *Financial Instruments: Presentation* and PBE IPSAS 41 *Financial Instruments* ~~PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*~~); and**

…

52.5 **PBE IFRS 9 *Financial Instruments*, issued in January 2017, amended paragraph 2. An entity shall apply that amendment when it applies PBE IFRS 9.***

* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.

…

52.7 **PBE IPSAS 41, issued in March 2019, amended paragraphs 2 and 52.5. An entity shall apply those amendments when it applies PBE IPSAS 41.**

PBE IPSAS 13 *Leases*

Paragraph 86.3 is renumbered and amended. Paragraph 86.5 is added. New text is underlined.

86.~~3~~4 **PBE IFRS 9 *Financial Instruments*, issued in January 2017, amended paragraph B7. An entity shall apply that amendment when it applies PBE IFRS 9.***

* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.

86.5 **PBE IPSAS 41 *Financial Instruments*, issued in March 2019, amended paragraphs 86.3 and B7. An entity shall apply those amendments when it applies PBE IPSAS 41.**

…

In Appendix B, paragraph B7 is amended.

B7. Other obligations of an arrangement, including any guarantees provided and obligations incurred upon early termination, shall be accounted for under ~~this Standard,~~ PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*, PBE IPSAS 41~~PBE IPSAS 29~~*Financial Instruments~~: Recognition and Measurement~~* or PBE IFRS 4 *Insurance Contracts*, depending on the terms.

PBE IPSAS 14 *Events After the Reporting Date*

Paragraphs 11 and 33.2 are amended. Paragraph 33.4 is added. New text is underlined and deleted text is struck through.

11. The following are examples of adjusting events after the reporting date that require an entity to adjust the amounts recognised in its financial statements, or to recognise items that were not previously recognised:

   (a) ...

   (b) The receipt of information after the reporting date indicating that an asset was impaired at the reporting date, or that the amount of a previously recognised impairment loss for that asset needs to be adjusted. For example:

(i) The bankruptcy of a debtor that occurs after the reporting date usually confirms that <u>the debtor was credit-impaired at the end of the reporting period</u> ~~a loss already existed at the reporting date on a receivable account, and that the entity needs to adjust the carrying amount of the receivable account~~;

…

33.2 **PBE IFRS 9 *Financial Instruments*, issued in January 2017, amended paragraph 11. An entity shall apply that amendment when it applies PBE IFRS 9.**<u>*</u>

<u>* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.</u>

…

<u>33.4 **PBE IPSAS 41 *Financial Instruments*, issued in March 2019, amended paragraphs 11 and 33.2. An entity shall apply those amendments when it applies PBE IPSAS 41.**</u>

PBE IPSAS 16 *Investment Property*

Paragraph 81 is amended. Paragraph 102.7 is added. New text is underlined and deleted text is struck through.

81. The consideration receivable on disposal of an investment property is recognised initially at fair value. In particular, if payment for an investment property is deferred, the consideration received is recognised initially at the cash price equivalent. The difference between the nominal amount of the consideration and the cash price equivalent is recognised as interest revenue in accordance with ~~PBE IPSAS 9~~<u>PBE IPSAS 41</u>, using the effective interest method.

…

102.7 <u>**PBE IPSAS 41 *Financial Instruments*, issued in March 2019, amended paragraph 81. An entity shall apply that amendment when it applies PBE IPSAS 41.**</u>

PBE IPSAS 17 *Property, Plant and Equipment*

Paragraph 87 is amended. Paragraph 108.12 is added. New text is underlined and deleted text is struck through.

87. The consideration receivable on disposal of an item of property, plant and equipment is recognised initially at its fair value. If payment for the item is deferred, the consideration received is recognised initially at the cash price equivalent. The difference between the nominal amount of the consideration and the cash price equivalent is recognised as interest revenue in accordance with ~~PBE IPSAS 9~~ <u>PBE IPSAS 41</u>, reflecting the effective <u>interest rate</u> ~~yield~~ on the receivable.

…

108.12 <u>**PBE IPSAS 41 *Financial Instruments*, issued in March 2019, amended paragraph 87. An entity shall apply that amendment when it applies PBE IPSAS 41.**</u>

PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*

Paragraphs 4 and 112.5 are amended. Paragraph 112.8 is added. New text is underlined and deleted text is struck through.

4. This Standard does not apply to financial instruments (including guarantees) that are within the scope of <u>PBE IPSAS 41 *Financial Instruments*</u> ~~PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*~~.

…

112.5 **PBE IFRS 9 <u>*Financial Instruments*</u>, issued in January 2017, amended paragraph 4. An entity shall apply that amendment when it applies PBE IFRS 9.**<u>*</u>

* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.

…

112.8 **PBE IPSAS 41, issued in March 2019, amended paragraphs 4 and 112.5. An entity shall apply those amendments when it applies PBE IPSAS 41.**

In the non-integral implementation guidance that accompanies PBE IPSAS 19, paragraph IG14 is deleted. New text is underlined and deleted text is struck through.

A Single Guarantee

IG14. [Deleted by IPSASB] ~~During 2004–05, a provincial government gives a guarantee of certain borrowings of a private sector operator providing public services for a fee, whose financial condition at that time is sound.~~
~~During 2005–06, the financial condition of the operator deteriorates and, at December 31 2005, the operator files for protection from its creditors.~~

~~This contract meets the definition of a financial guarantee contract in PBE IPSAS 29, except those where the issuer elects to treat such contracts as insurance contracts in accordance with PBE IFRS 4 *Insurance Contracts*. The following is an example of an accounting policy that complies with the requirements in PBE IPSAS 29 for financial guarantee contracts within the scope of PBE IPSAS 29.~~

~~**Analysis**~~

~~(a) At June 30 2005~~

~~Present obligation as a result of a past obligating event – The obligating event is the giving of the guarantee, which gives rise to a legal obligation.~~

~~An outflow of resources embodying economic benefits or service potential in settlement – No outflow of benefits is probable at June 30 2005.~~

~~**Conclusion**~~

~~The guarantee is recognised at fair value.~~

~~**Analysis**~~

~~(b) At June 30 2006~~

~~Present obligation as a result of a past obligating event – The obligating event is the giving of the guarantee, which gives rise to a legal obligation.~~

~~An outflow of resources embodying economic benefits or service potential in settlement – At June 30 2006, it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation.~~

~~**Conclusion**~~

~~The guarantee is subsequently measured at the higher of (a) the best estimate of the obligation (see paragraphs 22, 31 and 109), and (b) the amount initially recognised less, when appropriate, cumulative amortisation in accordance with PBE IPSAS 9 *Revenue from Exchange Transactions*.~~

PBE IPSAS 21 *Impairment of Non-Cash-Generating Assets*

Paragraphs 2, 9, 13 and 83.4 are amended. Paragraph 83.8 is added. New text is underlined and deleted text is struck through.

2. **An entity that prepares and presents financial statements shall apply this Standard in accounting for impairment of non-cash-generating assets, except:**

   (a) …

   (c) **Financial assets that are included in the scope of PBE IPSAS 41 *Financial Instruments* ~~PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*~~;**

…

9. This Standard does not apply to financial assets that are included in the scope of PBE IPSAS 28 *Financial Instruments: Presentation*. Impairment of these assets is dealt with in PBE IPSAS 41~~PBE IPSAS 29~~.

…

13. Investments in:

(a) Controlled entities, as defined in PBE IPSAS 35 *Consolidated Financial Statements*;

(b) Associates, as defined in PBE IPSAS 36 *Investments in Associates and Joint Ventures*; and

(c) Joint arrangements, as defined in PBE IPSAS 37 *Joint Arrangements*;

are financial assets that are excluded from the scope of PBE IPSAS 41~~29~~. Where such investments are classified as cash-generating assets, they are dealt with under PBE IPSAS 26. Where these assets are non-cash-generating assets, they are dealt with under this Standard.

…

83.4 **PBE IFRS 9 *Financial Instruments*, issued in January 2017, amended paragraphs 2, 9 and 13. An entity shall apply those amendments when it applies PBE IFRS 9.***

* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.

…

83.8 **PBE IPSAS 41 *Financial Instruments*, issued in March 2019, amended paragraphs 2, 9, 13 and 83.4. An entity shall apply those amendments when it applies PBE IPSAS 41.**

PBE IPSAS 23 *Revenue from Non-Exchange Transactions*

Paragraphs 43, 105A and 125.4 are amended. Paragraph 125.6 is added. New text is underlined and deleted text is struck through.

43. Consistent with PBE IPSAS 12 *Inventories*, PBE IPSAS 16 *Investment Property*, ~~and~~ PBE IPSAS 17~~,~~ and PBE IPSAS 41 *Financial Instruments* assets acquired through non-exchange transactions are measured at their fair value as at the date of acquisition.

…

105A. Concessionary loans are loans received by an entity at below market terms. The portion of the loan that is repayable, along with any interest payments, is an exchange transaction and is accounted for in accordance with PBE IPSAS 41 ~~PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*~~. An entity considers whether any difference between the transaction price (loan proceeds) and the fair value of the loan on initial recognition (see PBE IPSAS 41~~PBE IPSAS 29~~) is non-exchange revenue that should be accounted for in accordance with this Standard.

…

125.4 **PBE IFRS 9 *Financial Instruments*, issued in January 2017, amended paragraphs 105A and A54. An entity shall apply those amendments when it applies PBE IFRS 9.***

* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.

…

125.6 **PBE IPSAS 41, issued in March 2019, amended paragraphs 43, 105A, 125.4 and A54, renumbered paragraph A54.1 and added paragraphs A55 to A59. An entity shall apply those amendments when it applies PBE IPSAS 41.**

In the non-integral implementation guidance that accompanies PBE IPSAS 23, paragraph A54 is amended and paragraph A54.1 is renumbered (as A59.1). Paragraphs A55 to A59 are added. New text is underlined and deleted text is struck through.

A54. An entity receives CU6 million funding from a multi-lateral development agency to build 10 schools over the next 5 years. The funding is provided on the following conditions:

…

Analysis

…

The grant of CU1 million + CU784,550 is accounted for in accordance with this Standard and, the loan with its related contractual interest and capital payments, in accordance with PBE IPSAS 41 *Financial Instruments* ~~PBE IPSAS 29~~.

…

(Note: The journal entries for the repayment of interest and capital and interest accruals, have not been reflected in this example as it is intended to illustrate the recognition of revenue arising from concessionary loans. Comprehensive examples are included in the Illustrative Examples to PBE IPSAS 41~~29~~).

…

A55. An individual donates shares in listed Entity X to Entity A on January 1, 20X8. At that date, the shares in Entity X have a fair value of CU1,000,000. At December 31, 20X8, the fair value of the shares is CU900,000. As part of the arrangement, Entity A incurs the transfer duty to have the shares transferred into its name. These costs amount to CU10,000.

A56. Listed Entity X provides telecommunications infrastructure and related services to the public. During 20X9, new technology was introduced into the telecommunications industry, making the infrastructure and equipment used by Entity X almost obsolete. This resulted in a permanent decline in the value of listed Entity X. The value of the impairment loss as at December 31, 20X9 is CU700,000. Entity A measures investments in shares at fair value through net assets/equity when the shares are not held for trading. Assume that the arrangement is a contractual arrangement, no present obligations arise from the donation and that the entity's reporting period ends on December 31, 20X8.

Analysis

A57. As Entity A received the shares as a donation, it uses PBE IPSAS 23 to initially recognise the shares acquired and the related non-exchange revenue. However, because Entity A has acquired a financial asset, it considers the initial measurement requirements of PBE IPSAS 23 and PBE IPSAS 41.

A58. PBE IPSAS 23 prescribes that assets acquired as part of a non-exchange revenue transaction are initially measured at fair value, while PBE IPSAS 41 prescribes that financial assets are initially measured at fair value and, depending on their classification, transaction costs may or may not be included. As the entity has a policy of measuring investments in shares at fair value through other comprehensive revenue and expense, the transaction costs of CU10,000 are added to the value of the shares of CU1,000,000 on initial measurement.

A59. The subsequent measurement and derecognition of the shares is addressed in PBE IPSAS 41. The entity measures investments in shares at fair value through other comprehensive revenue and expense which means that the shares are measured at a fair value with any subsequent changes in fair value recognised in other comprehensive revenue and expense. Dividends are however recognised in surplus or deficit.

The journal entries at initial acquisition and at the reporting dates are as follows:

1. Acquisition of shares through donation

Dr		Investment in Entity X	CU1,010,000	
	Cr	Non-exchange revenue		CU1,000,000
	Cr	Bank (Transfer costs paid)		CU10,000

2. Subsequent measurement at December 31, 20X8

Dr		Other comprehensive revenue and expense (fair value adjustment of investment)	CU110,000	
	Cr	Investment in Entity X		CU110,000

3. Subsequent measurement at December 31, 20X9

Dr		Impairment loss (other comprehensive revenue and expense)	CU700,000	
	Cr	Investment in Entity X		CU700,000

…

A59.1~~A54.1~~ For the year ended December 31, 20X2, Entity B prepares and presents financial statements in accordance with PBE Standards. It makes the following disclosures in its financial statements:

…

PBE IPSAS 26 *Impairment of Cash-Generating Assets*

Paragraphs 2, 9, and 12 are amended. Paragraph 127.4 is renumbered and amended. Paragraph 127.9 is added. New text is underlined and deleted text is struck through.

2. **An entity that prepares and presents financial statements shall apply this Standard in accounting for the impairment of cash-generating assets, except for:**

(a) …

(c) **Financial assets that are within the scope of PBE IPSAS 41 *Financial Instruments* ~~PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*~~;**

…

9. This Standard does not apply to any financial assets that are included in the scope of PBE IPSAS 28 *Financial Instruments: Presentation*. Impairment of these assets is dealt with in PBE IPSAS 41 ~~PBE IPSAS 29~~.

…

12. Investments in:

(a) …

…

are financial assets that are excluded from the scope of PBE IPSAS 41 ~~PBE IPSAS 29~~. Where such investments …

…

127.~~4~~5 **PBE IFRS 9 *Financial Instruments*, issued in January 2017, amended paragraphs 2, 9 and 12. An entity shall apply those amendments when it applies PBE IFRS 9.***

* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.

…

127.9 **PBE IPSAS 41, issued in March 2019, amended paragraphs 2, 9, 12 and 127.4. An entity shall apply those amendments when it applies PBE IPSAS 41.**

PBE IPSAS 28 *Financial Instruments: Presentation*

Paragraphs 2, 3, 4, 9, 10, 14, 28, 36, 47, 48 and 62.4 are amended. Paragraph 62.6 is added. New text is underlined and deleted text is struck through.

2. The principles in this Standard complement the principles for recognising and measuring financial assets and financial liabilities in PBE IFRS 9 *Financial Instruments* ~~PBE IPSAS 29~~ ~~*Financial Instruments: Recognition and Measurement*~~ and for disclosing information about them in PBE IPSAS 30 *Financial Instruments: Disclosures*.

Scope (see also paragraphs AG3–AG9)

3. **An entity that prepares and presents financial statements shall apply this Standard to all types of financial instruments except:**

   (a) **Those interests in controlled entities, associates, or joint ventures that are accounted for in accordance with PBE IPSAS 34 *Separate Financial Statements*, PBE IPSAS 35 *Consolidated Financial Statements*, PBE IPSAS 36 *Investments in Associates and Joint Ventures.*~~*~~ However, in some cases, PBE IPSAS 34, 35 or 36 require or permit an entity to account for an interest in a controlled entity, associate, or joint venture using PBE IPSAS 41 ~~PBE IPSAS 29~~; in those cases, entities shall apply the requirements of this Standard. Entities shall also apply this Standard to all derivatives linked to interests in controlled entities, associates, or joint ventures.**

   ~~* An entity that applies this Standard before it applies PBE IPSASs 34–37 shall read references to PBE IPSASs 34–37 as references to PBE IPSASs 6–8.~~

   (b) ...

   (c) **Obligations arising from insurance contracts. However, this Standard applies to:**

   (i) **Derivatives that are embedded in insurance contracts if PBE IPSAS 41 ~~PBE IPSAS 29~~ requires the entity to account for them separately; and**

   (ii) **Financial guarantee contracts, if the issuer applies PBE IPSAS 41 ~~PBE IPSAS 29~~ in recognising and measuring the contracts, but shall apply PBE IFRS 4 *Insurance Contracts* if the issuer elects to apply that standard in recognising and measuring them.**

   In addition to (i) and (ii) above, an entity may apply this Standard to insurance contracts which involve the transfer of financial risk.

   (d) **Financial instruments that are within the scope of PBE IFRS 4 because they contain a discretionary participation feature. The issuer of these instruments is exempt from applying to these features paragraphs 15–32 and AG25–AG35 of this Standard regarding the distinction between financial liabilities and equity instruments. However, these instruments are subject to all other requirements of this Standard. Furthermore, this Standard applies to derivatives that are embedded in these instruments (see PBE IPSAS 41 ~~PBE IPSAS 29~~).**

   (e) ...

4. **This Standard shall be applied to those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements. However, this Standard shall be applied to those contracts that an entity designates as measured at fair value through surplus or deficit in accordance with paragraph 6 of PBE IPSAS 41.**

…

Definitions (see also paragraphs AG10–AG48)

9. **The following terms are used in this Standard with the meanings specified:**

…

A financial liability is any liability that is:

(a) **A contractual obligation:**

(i) **To deliver cash or another financial asset to another entity; or**

(ii) **To exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or**

(b) **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 deliver 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, rights, options or warrants to acquire a fixed number of an entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. Also for these purposes the entity's own equity instruments do not include puttable financial instruments classified as equity instruments in accordance with paragraphs 15 and 16, 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 paragraphs 17 and 18, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.**

As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraphs 15 and 16 or paragraphs 17 and 18.

…

10. The following terms are defined in paragraph 9 of PBE IPSAS 41 or paragraph 10 of PBE IPSAS 29 *Financial Instruments: Recognition and Measurement* and are used in this Standard with the meaning specified in that Standard.

- Amortised cost of a financial asset or financial liability;
- ~~Available-for-sale financial assets~~;
- ~~Derecognising~~ Derecognition;
- Derivative;
- Effective interest method;
- ~~Financial asset or financial liability at fair value through surplus or deficit;~~
- Financial guarantee contract;
- Financial liability at fair value through surplus or deficit;
- Firm commitment;
- Forecast transaction;
- Hedge effectiveness;
- Hedged item;
- Hedging instrument;
- ~~Held-to-maturity investments~~ Held for trading;
- ~~Loans and receivables;~~

- Regular way purchase or sale; and
- Transaction costs.

…

14. When an issuer applies the definitions in paragraph 9 to determine whether a financial instrument is an equity instrument rather than a financial liability, the instrument is an equity instrument if, and only if, both conditions (a) and (b) below are met.

    (a) The instrument includes no contractual obligation:

    (i) To deliver cash or another financial asset to another entity; or

    (ii) To exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.

    (b) If the instrument will or may be settled in the issuer's own equity instruments, it is:

    (i) A non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or

    (ii) A derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose~~,~~ rights, options or warrants to acquire a fixed number of an entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments, Also for these purposes the issuer's own equity instruments do not include instruments that have all the features and meet the conditions described in paragraphs 15 and 16 or paragraphs 17 and 18, or instruments that are contracts for the future receipt or delivery of the issuer's own equity instruments.

    A contractual obligation, including one arising from a derivative financial instrument, that will or may result in the future receipt or delivery of the issuer's own equity instruments, but does not meet conditions (a) and (b) above, is not an equity instrument. As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraphs 15 and 16 or paragraphs 17 and 18.

…

28. With the exception of the circumstances described in paragraphs 15 and 16 or paragraphs 17 and 18, a contract that contains an obligation for an entity to purchase its own equity instruments for cash or another financial asset gives rise to a financial liability for the present value of the redemption amount (e.g., for the present value of the forward repurchase price, option exercise price, or other redemption amount). This is the case even if the contract itself is an equity instrument. One example is an entity's obligation under a forward contract to purchase its own equity instruments for cash. ~~When~~ The financial liability is recognised initially at the present value of the redemption amount, and ~~under PBE IPSAS 29, its fair value (the present value of the redemption amount)~~ is reclassified from net assets/equity. Subsequently, the financial liability is measured in accordance with PBE IPSAS 41 ~~PBE IPSAS 29~~. If the contract expires without delivery, the carrying amount of the financial liability is reclassified to net assets/equity. An entity's contractual obligation to purchase its own equity instruments gives rise to a financial liability for the present value of the redemption amount even if the obligation to purchase is conditional on the counterparty exercising a right to redeem (e.g., a written put option that gives the counterparty the right to sell an entity's own equity instruments to the entity for a fixed price).

…

36. PBE IPSAS 41 ~~PBE IPSAS 29~~ deals with the measurement of financial assets and financial liabilities. Equity instruments evidence a residual interest in the assets of an entity after deducting all of its liabilities. Therefore, when the initial carrying amount of a compound financial instrument is allocated into its components, the net assets/equity component is assigned the residual amount after deducting from the fair value of the instrument as a whole the amount separately determined for the liability component. The value of any derivative features (such as a call option) embedded in the compound financial instrument is included in the liability component unless it forms part of the component of net assets/equity (such as an equity conversion option). The sum of the carrying amounts assigned to the liability and the net assets/equity components on initial recognition is always equal to the fair value that would be ascribed to

the instrument as a whole. No gain or loss arises from initially recognising the components of the instrument separately.

…

Offsetting a Financial Asset and a Financial Liability (see also paragraphs AG63A–AG63F and AG64)

47. **A financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position when, and only when, an entity:**

(a) …

(b) …

In accounting for a transfer of a financial asset that does not qualify for derecognition, the entity shall not offset the transferred asset and the associated liability (see PBE IPSAS 41 ~~PBE IPSAS 29~~, paragraph 33~~38~~).

48. This Standard requires the presentation of financial assets and financial liabilities on a net basis when doing so reflects an entity's expected future cash flows from settling two or more separate financial instruments. When an entity has the right to receive or pay a single net amount and intends to do so, it has, in effect, only a single financial asset or financial liability. In other circumstances, financial assets and financial liabilities are presented separately from each other consistently with their characteristics as resources or obligations of the entity. An entity shall disclose the information required in paragraphs 17B–17E in PBE IPSAS 30 for recognised financial instruments that are within the scope of paragraph 17A of PBE IPSAS 30.

…

62.4 **PBE IFRS 9 *Financial Instruments*, issued in January 2017, amended paragraphs 2, 3, 4, 10, 28, 36, 47, AG2, AG55, B19 and B21. An entity shall apply those amendments when it applies PBE IFRS 9.*[*]**

* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.

…

62.6 **PBE IPSAS 41, issued in March 2019, amended paragraphs 2, 3, 4, 9, 10, 14, 28, 36, 47, 48, 62.4, AG2, AG55, B19 and B21, added paragraphs AG63A–AG63F (and the related headings) and deleted paragraph AG63. An entity shall apply those amendments when it applies PBE IPSAS 41.**

In Appendix A, paragraphs AG2 and AG55 are amended. Paragraphs AG63A–AG63F (and the related headings) are added. Paragraph AG63 is deleted. New text is underlined and deleted text is struck through.

AG2. The Standard does not deal with the recognition or measurement of financial instruments. Requirements about the recognition and measurement of financial assets and financial liabilities are set out in PBE IPSAS 41 *Financial Instruments* ~~PBE IPSAS 29~~.

…

AG55. Paragraph 33 applies only to issuers of non-derivative compound financial instruments. Paragraph 33 does not deal with compound financial instruments from the perspective of holders. PBE IPSAS 41 deals with the classification and measurement of financial assets that are compound financial instruments from the holder's perspective. ~~PBE IPSAS 29 deals with the separation of embedded derivatives from the perspective of holders of compound financial instruments that contain the features of both debt and equity instruments.~~

Offsetting a Financial Asset and a Financial Liability (paragraphs 47–55)

AG63. [Deleted by IPSASB] ~~To offset a financial asset and a financial liability, an entity must have a currently enforceable legal right to set off the recognised amounts. An entity may have a conditional right to set off recognised amounts, such as in a master netting agreement or in some forms of non-recourse debt, but such rights are enforceable only on the occurrence of some future event, usually a default of the counterparty. Thus, such an arrangement does not meet the conditions for offset.~~

Criterion that an Entity 'Currently has a Legally Enforceable Right to Set off the Recognised Amounts' (paragraph 47(a))

AG63A. A right of set-off may be currently available or it may be contingent on a future event (for example, the right may be triggered or exercisable only on the occurrence of some future event, such as the default, insolvency or bankruptcy of one of the counterparties). Even if the right of set-off is not contingent on a future event, it may only be legally enforceable in the normal course of operations, or in the event of default, or in the event of insolvency or bankruptcy, of one or all of the counterparties.

AG63B. To meet the criterion in paragraph 47(a), an entity must currently have a legally enforceable right of set-off. This means that the right of set-off:

(a) Must not be contingent on a future event; and

(b) Must be legally enforceable in all of the following circumstances:

(i) The normal course of business;

(ii) The event of default; and

(iii) The event of insolvency or bankruptcy

of the entity and all of the counterparties.

AG63C. The nature and extent of the right of set-off, including any conditions attached to its exercise and whether it would remain in the event of default or insolvency or bankruptcy, may vary from one legal jurisdiction to another. Consequently, it cannot be assumed that the right of set-off is automatically available outside of the normal course of operations. For example, the bankruptcy or insolvency laws of a jurisdiction may prohibit, or restrict, the right of set-off in the event of bankruptcy or insolvency in some circumstances.

AG63D. The laws applicable to the relationships between the parties (for example, contractual provisions, the laws governing the contract, or the default, insolvency or bankruptcy laws applicable to the parties) need to be considered to ascertain whether the right of set-off is enforceable in the normal course of operations, in an event of default, and in the event of insolvency or bankruptcy, of the entity and all of the counterparties (as specified in paragraph AG63B(b)).

Criterion that an Entity 'Intends Either to Settle on a Net Basis, or to Realise the Asset and Settle the Liability Simultaneously' (paragraph 47(b))

AG63E. To meet the criterion in paragraph 47(b) an entity must intend either to settle on a net basis or to realise the asset and settle the liability simultaneously. Although the entity may have a right to settle net, it may still realise the asset and settle the liability separately.

AG63F. If an entity can settle amounts in a manner such that the outcome is, in effect, equivalent to net settlement, the entity will meet the net settlement criterion in paragraph 47(b). This will occur if, and only if, the gross settlement mechanism has features that eliminate or result in insignificant credit and liquidity risk, and that will process receivables and payables in a single settlement process or cycle. For example, a gross settlement system that has all of the following characteristics would meet the net settlement criterion in paragraph 47(b):

(a) Financial assets and financial liabilities eligible for set-off are submitted at the same point in time for processing;

(b) Once the financial assets and financial liabilities are submitted for processing, the parties are committed to fulfil the settlement obligation;

(c) There is no potential for the cash flows arising from the assets and liabilities to change once they have been submitted for processing (unless the processing fails—see (d) below);

(d) Assets and liabilities that are collateralised with securities will be settled on a securities transfer or similar system (for example, delivery versus payment), so that if the transfer of securities fails, the processing of the related receivable or payable for which the securities are collateral will also fail (and vice versa);

(e) Any transactions that fail, as outlined in (d), will be re-entered for processing until they are settled;

(f) Settlement is carried out through the same settlement institution (for example, a settlement bank, a central bank or a central securities depository); and

(g) An intraday credit facility is in place that will provide sufficient overdraft amounts to enable the processing of payments at the settlement date for each of the parties, and it is virtually certain that the intraday credit facility will be honoured if called upon.

In Appendix B, paragraphs B19 and B21 are amended. New text is underlined and deleted text is struck through.

B19. Members' shares in excess of the prohibition against redemption are financial liabilities. The co-operative entity measures this financial liability at fair value at initial recognition. Because these shares are redeemable on demand, the co-operative entity measures ~~determines~~ the fair value of such financial liabilities in accordance with ~~as required by~~ paragraph 68 of PBE IPSAS 41 *Financial Instruments* ~~52 of PBE IPSAS 29~~, which states: "The fair value of a financial liability with a demand feature (e.g., a demand deposit) is not less than the amount payable on demand …". Accordingly, the co-operative entity classifies as financial liabilities the maximum amount payable on demand under the redemption provisions.

…

B21. Following the change in its governing charter the co-operative entity can now be required to redeem a maximum of 25 percent of its outstanding shares or a maximum of 50,000 shares at CU20 each. Accordingly, on January 1, 20X3 the co-operative entity classifies as financial liabilities an amount of CU1,000,000 being the maximum amount payable on demand under the redemption provisions, as determined in accordance with paragraph 68 of PBE IPSAS 41 ~~52 of PBE IPSAS 28~~. It therefore transfers on January 1, 20X3 from net assets/equity to financial liabilities an amount of CU200,000, leaving CU2,000,000 classified as equity instruments. In this example the entity does not recognise a gain or loss on the transfer.

In the NZASB's Basis for Conclusions on PBE IPSAS 28, paragraph BC3 is amended. New text is underlined and deleted text is struck through.

BC3 The NZASB noted that both NZ IFRSs and IPSASs permit, in limited circumstances, an entity to elect to account for financial guarantee contracts as insurance contracts. The NZASB also noted that the circumstances in which this is permitted differ slightly between the two suites of standards. The NZASB considered that entities transitioning from NZ IFRS to PBE Standards should be required to continue their existing treatment in respect of financial guarantee contracts in existence at the time of transition. Apart from this modification, the NZASB considered that PBE IPSAS 28 and PBE IPSAS 29[1] should apply to financial guarantee contracts subsequently entered into by entities that have transitioned from NZ IFRS and to the financial guarantee contracts of all other entities.

[1] PBE IFRS 9 *Financial Instruments* was issued in January 2017. PBE IFRS 9 was superseded by PBE IPSAS 41 *Financial Instruments* issued in March 2019. Both PBE IFRS 9 and PBE IPSAS 41 carried forward this aspect of the scope of PBE IPSAS 29.

In the non-integral implementation guidance that accompanies PBE IPSAS 28, paragraphs IE1 and IE5 are amended. New text is underlined and deleted text is struck through.

IE1. The following examples illustrate the application of paragraphs 13–32 and PBE IPSAS 41 *Financial Instruments* ~~PBE IPSAS 29~~ to the accounting for contracts on an entity's own equity instruments. In these examples, monetary amounts are denominated in "currency units" (CU).

…

IE5. Assume the same facts as in (a) except that …

February 1, 20X2

Dr …

Cr …

To record the obligation to deliver CU104,000 in one year at its present value of CU100,000 discounted using an appropriate interest rate (see PBE IPSAS 41, paragraph AG1151 ~~PBE IPSAS 29, paragraph AG82~~).

PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*

Paragraphs 2, 9, 10, 80, 98–102, 107, 109, 112, 113 and 126.5 are amended, paragraph 126.8 is added and paragraphs 1, 3–6, 11–79 and 88 (and some related headings) are deleted. New text is underlined and deleted text is struck through.

~~Objective~~

1. [Deleted by IPSASB] ~~The objective of this Standard is to establish principles for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. Requirements for presenting information about financial instruments are in PBE IPSAS 28 *Financial Instruments: Presentation*. Requirements for disclosing information about financial instruments are in PBE IPSAS 30 *Financial Instruments: Disclosures.*~~

Scope

2. **This Standard shall be applied by all entities to all ~~types of~~ financial instruments within the scope of PBE IPSAS 41 *Financial Instruments* if, and to the extent that~~, except~~:**

   (a) **PBE IPSAS 41 permits the hedge accounting requirements of this Standard to be applied; and**

   (b) **The financial instrument is part of a hedging relationship that qualifies for hedge accounting in accordance with this Standard.**

   ~~(a) **Those interests in controlled entities, associates and joint ventures that are accounted for in accordance with PBE IPSAS 34 *Separate Financial Statements*, PBE IPSAS 35 *Consolidated Financial Statements* or PBE IPSAS 36 *Investments in Associates and Joint Ventures*. However, in some cases, PBE IPSAS 34, PBE IPSAS 35 or PBE IPSAS 36 require or permit an entity to account for an interest in a controlled entity, associate, or joint venture in accordance with some or all of the requirements in this Standard. Entities shall also apply this Standard to derivatives on an interest in a controlled entity, associate, or joint venture unless the derivative meets the definition of an equity instrument of the entity in PBE IPSAS 28.**~~

   ~~(b) **Rights and obligations under leases to which PBE IPSAS 13 *Leases* applies. However:**~~

      ~~(i) **Lease receivables recognised by a lessor are subject to the derecognition and impairment provisions of this Standard (see paragraphs 17–39, 67, 68, 72, and Appendix A paragraphs AG51–AG67 and AG117–AG126);**~~

      ~~(ii) **Finance lease payables recognised by a lessee are subject to the derecognition provisions of this Standard (see paragraphs 41–44 and Appendix A paragraphs AG72–AG80); and**~~

      ~~(iii) **Derivatives that are embedded in leases are subject to the embedded derivatives provisions of this Standard (see paragraphs 11–15 and Appendix A paragraphs AG40–AG46).**~~

   (c)–(k) [Deleted by IPSASB]

   ~~(c) **Employers' rights and obligations under employee benefit plans, to which PBE IPSAS 39 *Employee Benefits* applies.**~~

   ~~(d) **Financial instruments issued by the entity that meet the definition of an equity instrument in PBE IPSAS 28 (including options and warrants) or that are required to be classified as an equity instrument in accordance with paragraphs 15 and 16 or 17 and 18 of PBE IPSAS 28. However, the holder of such equity instruments shall apply this Standard to those instruments, unless they meet the exception in (a) above.**~~

   ~~(e) **Rights and obligations arising under:**~~

      ~~(i) **An insurance contract, other than an issuer's rights and obligations arising under an insurance contract that meets the definition of a financial guarantee contract in paragraph 10; or**~~

~~(ii) **A contract that is within the scope of PBE IFRS 4 *Insurance Contracts* because it contains a discretionary participation feature.**~~

~~**This Standard applies to a derivative that is embedded in an insurance contract if the derivative is not itself an insurance contract (see paragraphs 11–15 and Appendix A paragraphs AG40–AG46 of this Standard). An entity applies this Standard to financial guarantee contracts, but shall apply PBE IFRS 4 *Insurance Contracts* if the issuer elects to apply that standard in recognising and measuring them. Notwithstanding (i) above, an entity may apply this Standard to other insurance contracts which involve the transfer of financial risk.**~~

~~(f) **Any forward contracts between an acquirer and seller to buy or sell an acquiree that will result in an entity combination at a future acquisition date. The term of the forward contract should not exceed a reasonable period normally necessary to obtain any required approvals and to complete the transaction.**~~

~~(g) **Loan commitments other than those loan commitments described in paragraph 4. An issuer of loan commitments shall apply PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* to loan commitments that are not within the scope of this Standard. However, all loan commitments are subject to the derecognition provisions of this Standard (see paragraphs 17–44 and Appendix A paragraphs AG51–AG80).**~~

~~(h) **Financial instruments, contracts and obligations under share-based payment transactions to which the relevant international or national accounting standard dealing with share based payment applies, except for contracts within the scope of paragraphs 4–6 of this Standard, to which this Standard applies.**~~

~~(i) **Rights to payments to reimburse the entity for expenditure it is required to make to settle a liability that it recognises as a provision in accordance with PBE IPSAS 19, or for which, in an earlier period, it recognised a provision in accordance with PBE IPSAS 19.**~~

~~(j) **The initial recognition and initial measurement of rights and obligations arising from non-exchange revenue transactions, to which PBE IPSAS 23 *Revenue from Non-Exchange Transactions* applies.**~~

~~(k) **Rights and obligations under service concession arrangements to which PBE IPSAS 32 *Service Concession Arrangements: Grantor* applies. However, financial liabilities recognised by a grantor under the financial liability model are subject to the derecognition provisions of this Standard (see paragraphs 41–44 and Appendix A paragraphs AG72–AG80).**~~

3–6 [Deleted by IPSASB]

…

9. The terms defined in PBE IPSAS 9, PBE IPSAS 28 and PBE IPSAS 41 are used in this Standard with the meanings specified in paragraph 11 of PBE IPSAS 9, paragraph 9 of PBE IPSAS 28 and paragraph 9 of PBE IPSAS 41. PBE IPSAS 9, PBE IPSAS 28 and PBE IPSAS 41 define~~s~~ the following terms:

- Amortised cost of a financial asset or financial liability;
- Derecognition;
- Derivative;
- Effective interest method;
- Effective interest rate;
- Equity instrument;
- Fair value;
- Financial asset;
- Financial instrument;
- Financial liability;~~ and~~
- Firm commitment; and

- Forecast transaction.

and provides guidance on applying those definitions.

10. **The following terms are used in this Standard with the meanings specified:**

***~~Definition of a derivative~~* …**

***~~Definitions of four categories of financial instruments~~* …**
[Note: The deleted definitions are: definitions of a financial asset or financial liability at fair value through surplus or deficit, held-to-maturity investments, loans and receivables, available-for-sale financial assets]

***~~Definition of a financial guarantee contract~~* …**

***~~Definitions relating to recognition and measurement~~* …**

[Note: The deleted definitions are: the amortised cost of a financial asset or financial liability, the effective interest method, derecognition, a regular way purchase or sale, transaction costs]
…

~~Embedded Derivatives~~

11–79. [Deleted by IPSASB]

Hedging

80. **If an entity applies PBE IPSAS 41 and has not chosen as its accounting policy to continue to apply the hedge accounting requirements of this Standard (see paragraph 179 of PBE IPSAS 41), it shall apply the hedge accounting requirements in paragraphs 113–155 of PBE IPSAS 41. However, for a fair value hedge of the interest rate exposure of a portion of a portfolio of financial assets or financial liabilities, an entity may, in accordance with paragraph 115 of PBE IPSAS 41, apply the hedge accounting requirements in this Standard instead of those in PBE IPSAS 41. In that case the entity must also apply the specific requirements for fair value hedge accounting for a portfolio hedge of interest rate risk (see paragraphs 91, 100 and AG157–AG175). ~~If there is a designated hedging relationship between a hedging instrument and a hedged item as described in paragraphs 95–98 and Appendix A paragraphs AG142–AG144, accounting for the gain or loss on the hedging instrument and the hedged item shall follow paragraphs 99–113.~~**

…

88. [Deleted by IPSASB] ~~Unlike loans and receivables, a held-to-maturity investment cannot be a hedged item with respect to interest-rate risk or prepayment risk because designation of an investment as held to maturity requires an intention to hold the investment until maturity without regard to changes in the fair value or cash flows of such an investment attributable to changes in interest rates. However, a held-to-maturity investment can be a hedged item with respect to risks from changes in foreign currency exchange rates and credit risk.~~

…

98. **A hedging relationship qualifies for hedge accounting under paragraphs 99–113 if, and only if, all of the following conditions are met.**

    (a) ...

    (d) **The effectiveness of the hedge can be reliably measured, i.e., the fair value or cash flows of the hedged item that are attributable to the hedged risk and the fair value of the hedging instrument can be reliably measured ~~(see paragraphs 48 and 49 and Appendix A paragraphs AG113 and AG114 for guidance on determining fair value)~~.**

    (e) ...

Fair Value Hedges

99. **If a fair value hedge meets the conditions in paragraph 98 during the period, it shall be accounted for as follows:**

    (a) ...

(b) **The gain or loss on the hedged item attributable to the hedged risk shall adjust the carrying amount of the hedged item and be recognised in surplus or deficit. This applies if the hedged item is otherwise measured at cost. Recognition of the gain or loss attributable to the hedged risk in surplus or deficit applies if the hedged item is ~~an available-for-sale financial asset~~ a financial asset measured at fair value through other comprehensive revenue and expense in accordance with paragraph 41 of PBE IPSAS 41.**

…

101. If only particular risks attributable to a hedged item are hedged, recognised changes in the fair value of the hedged item unrelated to the hedged risk are recognised as set out in ~~paragraph 64~~ paragraph 101 of PBE IPSAS 41.

102. **An entity shall discontinue prospectively the hedge accounting specified in paragraph 99 if:**

(a) **The hedging instrument expires or is sold, terminated or exercised. ~~(for~~For this purpose, the replacement or rollover of a hedging instrument into another hedging instrument is not an expiration or termination if such replacement or rollover is part of the entity's documented hedging strategy.~~);~~ Additionally, for this purpose there is not an expiration or termination of the hedging instrument if:**

(i) **As a consequence of laws or regulations or the introduction of laws or regulations, the parties to the hedging instrument agree that one or more clearing counterparties replace their original counterparty to become the new counterparty to each of the parties. For this purpose, a clearing counterparty is a central counterparty (sometimes called a 'clearing organisation' or 'clearing agency') or an entity or entities, for example, a clearing member of a clearing organisation or a client of a clearing member of a clearing organisation, that are acting as counterparty in order to effect clearing by a central counterparty. However, when the parties to the hedging instrument replace their original counterparties with different counterparties this paragraph shall apply only if each of those parties effects clearing with the same central counterparty.**

(ii) **Other changes, if any, to the hedging instrument are limited to those that are necessary to effect such a replacement of the counterparty. Such changes are limited to those that are consistent with the terms that would be expected if the hedging instrument were originally cleared with the clearing counterparty. These changes include changes in the collateral requirements, rights to offset receivables and payables balances, and charges levied.**

(b) **The hedge no longer meets the criteria for hedge accounting in paragraph 98; or**

(c) **The entity revokes the designation.**

…

107. More specifically, a cash flow hedge is accounted for as follows:

(a) ...

(c) If an entity's documented risk management strategy for a particular hedging relationship excludes from the assessment of hedge effectiveness a specific component of the gain or loss or related cash flows on the hedging instrument (see paragraphs 83, 84, and 98(a)), that excluded component of gain or loss is recognised in accordance with paragraph ~~64~~101 of PBE IPSAS 41.

…

109. **If a hedge of a forecast transaction subsequently results in the recognition of a non-financial asset or a non-financial liability, or a forecast transaction for a non-financial asset or non-financial liability becomes a firm commitment for which fair value hedge accounting is applied, then the entity shall adopt (a) or (b) below:**

(a) **It reclassifies the associated gains and losses that were recognised in other comprehensive revenue and expense in accordance with paragraph 106 into surplus or deficit as a reclassification adjustment in the same period or periods during which the asset acquired or liability assumed affects surplus or deficit (such as in the periods that depreciation or inventories are recognised as an expense). However, if an entity expects that all or a portion of a loss recognised in other comprehensive revenue and expense will not be recovered in one**

or more future periods, it shall reclassify from net assets/equity into surplus or deficit as a reclassification adjustment the amount that is not expected to be recovered.

(b) **It removes the associated gains and losses that were recognised in other comprehensive revenue and expense in accordance with paragraph 106, and includes them in the initial cost or other carrying amount of the asset or liability.**

…

112. **In any of the following circumstances an entity shall discontinue prospectively the hedge accounting specified in paragraphs 106–111:**

(a) **The hedging instrument expires or is sold, terminated or exercised ~~(for this purpose, the replacement or rollover of a hedging instrument into another hedging instrument is not an expiration or termination if such replacement or rollover is part of the entity's documented hedging strategy)~~. In this case, the cumulative gain or loss on the hedging instrument that has been recognised in other comprehensive revenue and expense from the period when the hedge was effective (see paragraph 106(a)) shall remain separately in net assets/equity until the forecast transaction occurs. When the transaction occurs, paragraph 108, 109 or 111 applies. For the purpose of this subparagraph, the replacement or rollover of a hedging instrument into another hedging instrument is not an expiration or termination if such replacement or rollover is part of the entity's documented hedging strategy. Additionally, for the purpose of this subparagraph there is not an expiration or termination of the hedging instrument if:**

(i) **As a consequence of laws or regulations or the introduction of laws or regulations, the parties to the hedging instrument agree that one or more clearing counterparties replace their original counterparty to become the new counterparty to each of the parties. For this purpose, a clearing counterparty is a central counterparty (sometimes called a 'clearing organisation' or 'clearing agency') or an entity or entities, for example, a clearing member of a clearing organisation or a client of a clearing member of a clearing organisation, that are acting as counterparty in order to effect clearing by a central counterparty. However, when the parties to the hedging instrument replace their original counterparties with different counterparties this paragraph shall apply only if each of those parties effects clearing with the same central counterparty.**

(ii) **Other changes, if any, to the hedging instrument are limited to those that are necessary to effect such a replacement of the counterparty. Such changes are limited to those that are consistent with the terms that would be expected if the hedging instrument were originally cleared with the clearing counterparty. These changes include changes in the collateral requirements, rights to offset receivables and payables balances, and charges levied.**

(b) …

Hedges of a Net Investment

113. **Hedges of a net investment in a foreign operation, including a hedge of a monetary item that is accounted for as part of the net investment (see PBE IPSAS 4), shall be accounted for similarly to cash flow hedges:**

(a) **The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge (see paragraph 98) shall be recognised in other comprehensive revenue and expense (see PBE IPSAS 1); and**

(b) **The ineffective portion shall be recognised in surplus or deficit.**

The gain or loss on the hedging instrument relating to the effective portion of the hedge that has been recognised in other comprehensive revenue and expense shall be reclassified from net assets/equity to surplus or deficit as a reclassification adjustment (see PBE IPSAS 1) in accordance with paragraphs 56–57 of PBE IPSAS 4 on disposal or partial disposal of the foreign operation.

…

126.5 PBE IFRS 9 *Financial Instruments*, issued in January 2017, amended paragraphs 2, 9, 10, 80, 98–101, 107, AG128, AG157, AG161, deleted paragraphs 1, 3–6, 11–79, 88, AG1–AG126 and AG129. An entity shall apply those amendments when it applies PBE IFRS 9.*

* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.

…

126.8 PBE IPSAS 41, issued in March 2019, amended paragraphs 2, 9, 10, 80, 98–102, 107, 109, 112, 113, 126.5, AG128, AG134, AG157, AG161, added AG156A and deleted paragraphs 1, 3–6, 11–79, 88, 126.8, AG1–AG126 and AG129. An entity shall apply those amendments when it applies PBE IPSAS 41.

Paragraphs AG128, AG134, AG157 and AG161 are amended. Paragraph AG156A is added. Paragraphs AG1–AG126 and AG129 (and some related headings) are deleted. New text is underlined and deleted text is struck through.

AG1–AG126. [Deleted by IPSASB]

…

AG128. A financial asset measured ~~held-to-maturity investment carried~~ at amortised cost may be designated as a hedging instrument in a hedge of foreign currency risk.

AG129. [Deleted by IPSASB]

…

AG134. If a hedge of a forecast transaction within the economic entity qualifies for hedge accounting, any gain or loss that is recognised in other comprehensive revenue and expense in accordance with paragraph 106(a) shall be reclassified from net assets/equity into surplus or deficit as a reclassification adjustment in the same period or periods during which the foreign currency risk of the hedged transaction affects consolidated surplus or deficit.

…

AG156A. For the avoidance of doubt, the effects of replacing the original counterparty with a clearing counterparty and making the associated changes as described in paragraphs 102(a)(ii) and 112(a)(ii) shall be reflected in the measurement of the hedging instrument and therefore in the assessment of hedge effectiveness and the measurement of hedge effectiveness.

Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk

AG157. For a fair value hedge of interest rate risk associated with a portfolio of financial assets or financial liabilities, an entity would meet the requirements of this Standard if it complies with the procedures set out in (a)–(i) and paragraphs AG158–AG175 below.

(a) As part of its risk management process the entity identifies a portfolio of items whose interest rate risk it wishes to hedge. The portfolio may comprise only assets, only liabilities or both assets and liabilities. The entity may identify two or more portfolios ~~(e.g., the entity may group its available-for-sale assets into a separate portfolio)~~, in which case it applies the guidance below to each portfolio separately

(b) ...

…

AG161. As an example of the designation set out in paragraph AG157(c), if in a particular repricing time period an entity estimates that it has fixed rate assets of CU100 and fixed rate liabilities of CU80 and decides to hedge all of the net position of CU20, it designates as the hedged item assets in the amount of CU20 (a portion of the assets is designated as the Standard permits an entity to designate any amount of the available qualifying assets or liabilities, i.e., in this example any amount of the assets between CU0 and CU100). The designation is expressed as an "amount of a currency" (e.g., an amount of dollars, euro, pounds or rand) rather than as individual assets. It follows that all of the assets (or liabilities) from which the hedged amount is drawn – i.e., all of the CU100 of assets in the above example – must be:

(a) ...

(b) Items that could have qualified for fair value hedge accounting if they had been designated as hedged individually. In particular, because PBE IPSAS 41 *Financial Instruments* ~~paragraph 52 of the Standard~~ specifies that the fair value of a financial liability with a demand feature (such as demand deposits and some types of time deposits) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid, such an item cannot qualify for fair value hedge accounting for any time period beyond the shortest period in which the holder can demand payment. In the above example, the hedged position is an amount of assets. Hence, such liabilities are not a part of the designated hedged item, but are used by the entity to determine the amount of the asset that is designated as being hedged. If the position the entity wished to hedge was an amount of liabilities, the amount representing the designated hedged item must be drawn from fixed rate liabilities other than liabilities that the entity can be required to repay in an earlier time period, and the percentage measure used for assessing hedge effectiveness in accordance with paragraph AG169(b) would be calculated as a percentage of these other liabilities. For example, assume that an entity estimates that in a particular repricing time period it has fixed rate liabilities of CU100, comprising CU40 of demand deposits and CU60 of liabilities with no demand feature, and CU70 of fixed rate assets. If the entity decides to hedge all of the net position of CU30, it designates as the hedged item liabilities of CU30 or 50 percent (CU30 / (CU100 - CU40) = 50 percent) of the liabilities with no demand feature.

Appendix B *Reassessment of Embedded Derivatives* is deleted.

Appendix B
Reassessment of Embedded Derivatives

B1–B7. [Deleted by IPSASB]

Appendix C *Hedges of a Net Investment in a Foreign Operation* is deleted.

Appendix C
Hedges of a Net Investment in a Foreign Operation

C1–C29. [Deleted by IPSASB]

In the non-integral implementation guidance that accompanies PBE IPSAS 29, sections A–G are deleted.

Implementation Guidance

Sections A–G [Deleted by IPSASB]

Paragraph BC2 is deleted. New text is underlined and deleted text is struck through.

BC2. [Not used] ~~The NZASB decided that the IPSASB's Basis for Conclusions on IPSAS 29 includes information that would be useful for entities applying PBE IPSAS 29 and agreed to reproduce that Basis for Conclusions together with PBE IPSAS 29.~~

In the non-integral illustrative examples that accompany PBE IPSAS 29, paragraphs IE32–IE50 are deleted.

Illustrative Examples

IE32–IE50. [Deleted by IPSASB]

PBE IPSAS 30 *Financial Instruments: Disclosures*

Paragraphs 2–5, 8, 11, RDR 11.1, 12–13, 14, 18, 24, RDR 24.1, 34–37, 43, 45 and 53.5 are amended.
Paragraphs 5A, 13A, 14A–14B, 15A–15C, 17A–17F, 20A, 24A, 25A–25D, 26A–26C, 27A–27F, 28A–28F, 28G, 37A, 39A, 42A–42N, 49A–49S, 53.7 and several headings are added.
Paragraphs RDR 11.2, 15–17 (and the heading preceding paragraph 17), 20, 26, 27, RDR 27.1, 28, 44 and 53.5 are deleted.
New text is underlined and deleted text is struck through.

2. The principles in this Standard complement the principles for recognising, measuring, and presenting financial assets and financial liabilities in PBE IPSAS 28 *Financial Instruments: Presentation* and PBE IPSAS 41 *Financial Instruments* ~~PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*~~.

Scope

3. **This Standard shall be applied by all entities to all types of financial instruments, except:**

   (a) **Those interests in controlled entities, associates, or joint ventures that are accounted for in accordance with PBE IPSAS 34 *Separate Financial Statements,* PBE IPSAS 35 *Consolidated Financial Statements*, PBE IPSAS 36 *Investments in Associates and Joint Ventures.* However, in some cases, PBE IPSAS 34, 35 or 36 require or permits an entity to account for an interest in a controlled entity, associate, or joint venture using ~~PBE IPSAS 29~~ PBE IPSAS 41; in those cases, entities shall apply the requirements of this Standard. Entities shall also apply this Standard to all derivatives linked to interests in controlled entities, associates, or joint ventures unless the derivative meets the definition of an equity instrument in PBE IPSAS 28.**

   (b) …

   (c) **Rights and obligations arising under insurance contracts. However, this Standard applies to:**

      (i) **Derivatives that are embedded in insurance contracts if ~~PBE IPSAS 29~~ PBE IPSAS 41 requires the entity to account for them separately; and**

      (ii) **An issuer of financial guarantee contracts if the issuer applies ~~PBE IPSAS 29~~ PBE IPSAS 41 in recognising and measuring the contracts, but shall apply PBE IFRS 4 *Insurance Contracts* if the issuer elects to apply that standard in recognising and measuring them.**

      In addition to (i) and (ii) above, an entity may apply this Standard to insurance contracts which involve the transfer of financial risk.

   (d) **Financial instruments, contracts, and obligations under share-based payment transactions to which the relevant international or national accounting standard dealing with share-based payment applies, except that this Standard applies to ~~for~~ contracts within the scope of PBE IPSAS 41 ~~paragraphs 4–6 of PBE IPSAS 29, to which that Standard applies~~.**

   (e) …

   …

4. This Standard applies to recognised and unrecognised financial instruments. Recognised financial instruments include financial assets and financial liabilities that are within the scope of ~~PBE IPSAS 29~~ PBE IPSAS 41. Unrecognised financial instruments include some financial instruments that, although outside the scope of ~~PBE IPSAS 29~~ PBE IPSAS 41, are within the scope of this Standard (such as some loan commitments).

5. This Standard applies to contracts to buy or sell a non-financial item that are within the scope of ~~PBE IPSAS 29~~ PBE IPSAS 41 (see paragraphs 6–8 of PBE IPSAS 41).

5A. The credit risk disclosure requirements in paragraphs 42A–42N apply to those rights for receivables that result from exchange transactions that are within the scope of PBE IPSAS 9 and non-exchange transactions within the scope of PBE IPSAS 23 which give rise to financial instruments for the purpose of recognising impairment gains or losses in accordance with paragraph 3 of PBE IPSAS 41. Any reference to financial assets or financial instruments in these paragraphs shall include those rights unless otherwise specified.

…

8. **The following terms are used in this Standard with the meanings specified:**

…

Credit risk rating grades is the rating of credit risk based on the risk of a default occurring on the financial instrument.

…

~~**A financial asset is**~~ **past due** ~~**when a counterparty has failed to make a payment when contractually due.**~~

...

Statement of Financial Position

Categories of Financial Assets and Financial Liabilities

11. The carrying amounts of each of the following categories, as defined in ~~PBE IPSAS 29~~ PBE IPSAS 41, shall be disclosed either in the statement of financial position or in the notes:

*(a) Financial assets measured at fair value through surplus or deficit, showing separately (i) those designated as such upon initial recognition, or subsequently in accordance with paragraph 152 of PBE IPSAS 41 and (ii) those ~~classified as held for trading in accordance with PBE IPSAS 29~~ mandatorily measured at fair value through surplus or deficit in accordance with PBE IPSAS 41;

(b)–(d)~~Held-to-maturity investments;~~ [Deleted by IPSASB]

~~(c) Loans and receivables;~~

~~(d) Available-for-sale financial assets;~~

*(e) Financial liabilities at fair value through surplus or deficit, showing separately (i) those designated as such upon initial recognition or subsequently in accordance with paragraph 152 of PBE IPSAS 41and (ii) those that meet the definition of held for trading in PBE IPSAS 41 ~~classified as held-for-trading in accordance with PBE IPSAS 29~~; ~~and~~

(f) Financial assets ~~liabilities~~ measured at amortised cost;~~.~~

(g) Financial liabilities measured at amortised cost; and

(h) Financial assets measured at fair value through other comprehensive revenue and expense; showing separately (i) financial assets that are measured at fair value through other comprehensive revenue and expense in accordance with paragraph 41 of PBE IPSAS 41; and (ii) investments in equity instruments designated as such upon initial recognition in accordance with paragraph 106 of PBE IPSAS 41.

RDR 11.1 A Tier 2 entity shall disclose, either in the statement of financial position or in the notes, the carrying amounts of (i) financial assets measured at fair value through surplus or deficit and (ii) financial liabilities measured at fair value through surplus or deficit. ~~is not required to make the separate disclosure required by paragraph 11(a).~~

~~RDR 11.2 A Tier 2 entity is not required to make the separate disclosure required by paragraph 11(e).~~

Financial Assets or Financial Liabilities at Fair Value through Surplus or Deficit

*12. If the entity has designated as measured at fair value through surplus or deficit a financial asset (or group of financial assets) that would otherwise be measured at fair value through other comprehensive revenue and expense or amortised cost, ~~a loan or receivable (or group of loans or receivables) as at fair value through surplus or deficit,~~ it shall disclose:

(a) The maximum exposure to credit risk (see paragraph 43(a)) of the financial asset (or group of financial assets) ~~loan or receivable (or group of loans or receivables)~~ at the end of the reporting period.

(b) The amount by which any related credit derivatives or similar instruments mitigate that maximum exposure to credit risk (see paragraph 43(b)).

(c) The amount of change, during the period and cumulatively, in the fair value of the financial asset (or group of financial assets) ~~loan or receivable (or group of loans or receivables)~~ that is attributable to changes in the credit risk of the financial asset determined either:

(i) …

(d) The amount of the change in the fair value of any related credit derivatives or similar instruments that has occurred during the period and cumulatively since the ~~loan or receivable~~ financial asset was designated.

*13. If the entity has designated a financial liability as at fair value through surplus or deficit in accordance with paragraph 46 of PBE IPSAS 41~~10 of PBE IPSAS 29,~~ and is required to present the effects of changes in that liability's credit risk in other comprehensive revenue and expense (see paragraph 108 of PBE IPSAS 41), it shall disclose:

(a) The amount of change, ~~during the period and~~ cumulatively, in the fair value of the financial liability that is attributable to changes in the credit risk of that liability (see paragraphs AG236- AG243 of PBE IPSAS 41 for guidance on determining the effects of changes in a liability's credit risk). ~~determined either:~~

~~(i) As the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk (see Appendix A, paragraph AG4); or~~

~~(ii) Using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the liability.~~

~~Changes in market conditions that give rise to market risk include changes in a benchmark interest rate, the price of another entity's financial instrument, a commodity price, a foreign exchange rate, or an index of prices or rates. For contracts that include a unit-linking feature, changes in market conditions include changes in the performance of the related internal or external investment fund.~~

(b) The difference between the financial liability's carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation.

(c) Any transfers of the cumulative gain or loss within net assets/equity during the period including the reason for such transfers.

(d) If a liability is derecognised during the period, the amount (if any) presented in other comprehensive revenue and expense that was realised at derecognition.

*13A. If an entity has designated a financial liability as at fair value through surplus or deficit in accordance with paragraph 46 of PBE IPSAS 41and is required to present all changes in the fair value of that liability (including the effects of changes in the credit risk of the liability) in surplus or deficit (see paragraphs 108 and 109 of PBE IPSAS 41), it shall disclose:

(a) The amount of change, during the period and cumulatively, in the fair value of the financial liability that is attributable to changes in the credit risk of that liability (see paragraphs AG236- AG243 of PBE IPSAS 41for guidance on determining the effects of changes in a liability's credit risk); and

(b) The difference between the financial liability's carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation.

*14. The entity shall also disclose:

(a) A detailed description of ~~T~~the methods used to comply with the requirements in paragraphs 12(c), ~~and~~ 13(a) and 13A(a) and paragraph 108(a) of PBE IPSAS 41, including an explanation of why the method is appropriate.

(b) If the entity believes that the disclosure it has given, either in the statement of financial position or in the notes, to comply with the requirements in paragraph 12(c), ~~or~~ 13(a) or 13A(a) or paragraph 108(a) of PBE IPSAS 41 does not faithfully represent the change in the fair value of the financial asset or financial liability attributable to changes in its credit risk, the reasons for reaching this conclusion and the factors it believes are relevant.

(c) A detailed description of the methodology or methodologies used to determine whether presenting the effects of changes in a liability's credit risk in other comprehensive revenue and expense would create or enlarge an accounting mismatch in surplus or deficit (see paragraphs 108 and 109 of PBE IPSAS 41). If an entity is required to present the effects of changes in a liability's credit risk in surplus or deficit (see paragraph 109 of PBE IPSAS 41), the disclosure must include a detailed description of the economic relationship described in paragraph AG229 of PBE IPSAS 41.

Investments in Equity Instruments Designated at Fair Value through Other Comprehensive Revenue and Expense

*14A. If an entity has designated investments in equity instruments to be measured at fair value through other comprehensive revenue and expense, as permitted by paragraph 106 of PBE IPSAS 41, it shall disclose:

(a) Which investments in equity instruments have been designated to be measured at fair value through other comprehensive revenue and expense.

(b) The reasons for using this presentation alternative.

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

(d) Dividends recognised during the period, showing separately those related to investments derecognised during the reporting period and those related to investments held at the end of the reporting period.

(e) Any transfers of the cumulative gain or loss within net assets/equity during the period including the reason for such transfers.

*14B. If an entity derecognised investments in equity instruments measured at fair value through other comprehensive revenue and expense during the reporting period, it shall disclose:

(a) The reasons for disposing of the investments.

(b) The fair value of the investments at the date of derecognition.

(c) The cumulative gain or loss on disposal.

Reclassification

15 [Deleted by IPSASB]

~~15. If the entity has reclassified a financial asset (in accordance with paragraphs 60–63 of PBE IPSAS 29) as one measured:~~

~~(a) At cost or amortised cost, rather than at fair value; or~~

~~(b) At fair value, rather than at cost or amortised cost;~~

~~it shall disclose the amount reclassified into and out of each category and the reason for that reclassification.~~

15A. An entity shall disclose if, in the current or previous reporting periods, it has reclassified any financial assets in accordance with paragraph 54 of PBE IPSAS 41. For each such event, an entity shall disclose:

(a) The date of reclassification.

(b) A detailed explanation of the change in management model and a qualitative description of its effect on the entity's financial statements.

(c) The amount reclassified into and out of each category.

*15B. For each reporting period following reclassification until derecognition, an entity shall disclose for assets reclassified out of the fair value through surplus or deficit category so that they are measured at amortised cost or fair value through other comprehensive revenue and expense in accordance with paragraph 54 of PBE IPSAS 41:

(a) The effective interest rate determined on the date of reclassification; and

(b) The interest revenue recognised.

15C. If, since its last annual reporting date, an entity has reclassified financial assets out of the fair value through other comprehensive revenue and expense category so that they are measured at amortised cost or out of the fair value through surplus or deficit category so that they are measured at amortised cost or fair value through other comprehensive revenue and expense it shall disclose:

(a) The fair value of the financial assets at the end of the reporting period; and

(b) The fair value gain or loss that would have been recognised in surplus or deficit or other comprehensive revenue or expense during the reporting period if the financial assets had not been reclassified.

16. [Deleted by IPSASB] ~~If the entity has reclassified a financial asset out of the fair value through surplus or deficit category in accordance with paragraph 55 or 57 of PBE IPSAS 29 or out of the available-for-sale category in accordance with paragraph 58 of PBE IPSAS 29, it shall disclose:~~

~~(a) The amount reclassified into and out of each category;~~

~~*(b) For each reporting period until derecognition, the carrying amounts and fair values of all financial assets that have been reclassified in the current and previous reporting periods;~~

~~(c) If a financial asset was reclassified in accordance with paragraph 55 of PBE IPSAS 29, the rare situation, and the facts and circumstances indicating that the situation was rare;~~

~~(d) For the reporting period when the financial asset was reclassified, the fair value gain or loss on the financial asset recognised in surplus or deficit or in other comprehensive revenue and expense in that reporting period and in the previous reporting period;~~

~~*(e) For each reporting period following the reclassification (including the reporting period in which the financial asset was reclassified) until derecognition of the financial asset, the fair value gain or loss that would have been recognised in surplus or deficit or in other comprehensive revenue and expense if the financial asset had not been reclassified, and the gain, loss, revenue, and expense recognised in surplus or deficit; and~~

~~(f) The effective interest rate and estimated amounts of cash flows the entity expects to recover, as at the date of reclassification of the financial asset.~~

~~*Derecognition*~~

17. [Deleted by IPSASB] ~~An entity may have transferred financial assets in such a way that part or all of the financial assets do not qualify for derecognition (see paragraphs 17–39 of PBE IPSAS 29). The entity shall disclose for each class of such financial assets:~~

~~(a) The nature of the assets;~~

~~(b) The nature of the risks and rewards of ownership to which the entity remains exposed;~~

~~(c) When the entity continues to recognise all of the assets, the carrying amounts of the assets, and of the associated liabilities; and~~

~~(d) When the entity continues to recognise the assets to the extent of its continuing involvement, the total carrying amount of the original assets, the amount of the assets that the entity continues to recognise, and the carrying amount of the associated liabilities.~~

Offsetting Financial Assets and Financial Liabilities

*17A. The disclosures in paragraphs 17B–17E supplement the other disclosure requirements of this Standard and are required for all recognised financial instruments that are set off in accordance with paragraph 47 of PBE IPSAS 28. These disclosures also apply to recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are set off in accordance with paragraph 47 of PBE IPSAS 28.

*17B. An entity shall disclose information to enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on the entity's financial position. This includes the effect or potential effect of rights of set-off associated with the entity's recognised financial assets and recognised financial liabilities that are within the scope of paragraph 17A.

*17C. To meet the objective in paragraph 17B, an entity shall disclose, at the end of the reporting period, the following quantitative information separately for recognised financial assets and recognised financial liabilities that are within the scope of paragraph 17A:

(a) The gross amounts of those recognised financial assets and recognised financial liabilities;

(b) The amounts that are set off in accordance with the criteria in paragraph 47 of PBE IPSAS 28 when determining the net amounts presented in the statement of financial position;

(c) The net amounts presented in the statement of financial position;

(d) The amounts subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in paragraph 17C(b), including:

(i) Amounts related to recognised financial instruments that do not meet some or all of the offsetting criteria in paragraph 47 of PBE IPSAS 28; and

(ii) Amounts related to financial collateral (including cash collateral); and

(e) The net amount after deducting the amounts in (d) from the amounts in (c) above.

The information required by this paragraph shall be presented in a tabular format, separately for financial assets and financial liabilities, unless another format is more appropriate.

*17D. The total amount disclosed in accordance with paragraph 17C(d) for an instrument shall be limited to the amount in paragraph 17C(c) for that instrument.

*17E. An entity shall include a description in the disclosures of the rights of set-off associated with the entity's recognised financial assets and recognised financial liabilities subject to enforceable master netting arrangements and similar agreements that are disclosed in accordance with paragraph 17C(d), including the nature of those rights.

*17F. If the information required by paragraphs 17B–17E is disclosed in more than one note to the financial statements, an entity shall cross-refer between those notes.

Collateral

18. An entity shall disclose:

(a) The carrying amount of financial assets it has pledged as collateral for liabilities or contingent liabilities, including amounts that have been reclassified in accordance with ~~paragraph 39(a) of PBE IPSAS 29~~ paragraph 34(a) of PBE IPSAS 41; and

(b) The terms and conditions relating to its pledge.

…

Allowance Account for Credit Losses

20. [Deleted by IPSASB] ~~When financial assets are impaired by credit losses and the entity records the impairment in a separate account (e.g., an allowance account used to record individual impairments or a similar account used to record a collective impairment of assets) rather than directly reducing the carrying amount of the asset, it shall disclose a reconciliation of changes in that account during the period for each class of financial assets.~~

20A. The carrying amount of financial assets measured at fair value through other comprehensive revenue and expense in accordance with paragraph 41 of PBE IPSAS 41is not reduced by a loss allowance and an entity shall not present the loss allowance separately in the statement of financial position as a reduction of the carrying amount of the financial asset. However, an entity shall disclose the loss allowance in the notes to the financial statements.

…

Statement of Comprehensive Revenue and Expense

Items of Revenue, Expense, Gains, or Losses

24. An entity shall disclose the following items of revenue, expense, gains, or losses either in the statement of comprehensive revenue and expense or in the notes:

(a) Net gains or net losses on:

*(i) Financial assets or financial liabilities measured at fair value through surplus or deficit, showing separately those on financial assets or financial liabilities designated as such upon

initial recognition or subsequently in accordance with paragraph 152 of PBE IPSAS 41, and those on financial assets or financial liabilities that are ~~classified as held for trading in accordance with PBE IPSAS 29~~ mandatorily measured at fair value through surplus or deficit in accordance with PBE IPSAS 41 (e.g., financial liabilities that meet the definition of held for trading in PBE IPSAS 41). For financial liabilities designated as at fair value through surplus or deficit, an entity shall show separately the amount of gain or loss recognised in other comprehensive revenue and expense and the amount recognised in surplus or deficit;

(ii)–(iv) [Deleted by IPSASB] ~~Available-for-sale financial assets, showing separately the amount of gain or loss recognised in other comprehensive revenue and expense during the period and the amount reclassified from net assets/equity to surplus or deficit for the period;~~

~~(iii) Held-to-maturity investments;~~

~~(iv) Loans and receivables; and~~

(v) Financial liabilities measured at amortised cost;

(vi) Financial assets measured at amortised cost;

(vii) Investments in equity instruments designated at fair value through other comprehensive revenue and expense in accordance with paragraph 106 of PBE IPSAS 41and

(viii) Financial assets measured at fair value through other comprehensive revenue and expense in accordance with paragraph 41 of PBE IPSAS 41, showing separately the amount of gain or loss recognised in other comprehensive revenue and expense during the period and the amount reclassified upon derecognition from accumulated other comprehensive revenue and expense to surplus or deficit for the period.

(b) Total interest revenue and total interest expense (calculated using the effective interest method) for financial assets that are measured at amortised cost or that are measured at fair value through other comprehensive revenue and expense in accordance with paragraph 41 of PBE IPSAS 41 (showing these amounts separately); or financial liabilities that are not measured at fair value through surplus or deficit;

*(c) Fee revenue and expense (other than amounts included in determining the effective interest rate) arising from:

(i) Financial assets or financial liabilities that are not at fair value through surplus or deficit; and

(ii) Trust and other fiduciary activities that result in the holding or investing of assets on behalf of individuals, trusts, retirement benefit plans, and other institutions~~;~~.

(d)–(e) [Deleted by IPSASB]

~~*(d) Interest revenue on impaired financial assets accrued in accordance with paragraph AG126 of PBE IPSAS 29; and~~

~~(e) The amount of any impairment loss for each class of financial asset.~~

RDR 24.1 A Tier 2 entity ~~is not required to make the separate disclosure required by paragraph 24(a)(i)~~ shall disclose, either in the statement of comprehensive revenue and expense or in the notes, net gains or losses on financial assets or financial liabilities measured at fair value through surplus or deficit. For financial liabilities designated as at fair value through surplus or deficit, an entity shall show separately the amount of gain or loss recognised in other comprehensive revenue and expense and the amount recognised in surplus or deficit.

*24A. An entity shall disclose an analysis of the gain or loss recognised in the statement of comprehensive revenue and expense arising from the derecognition of financial assets measured at amortised cost, showing separately gains and losses arising from derecognition of those financial assets. This disclosure shall include the reasons for derecognising those financial assets.

…

Hedge Accounting

25A. An entity shall apply the disclosure requirements in paragraphs 25B–28F for those risk exposures that an entity hedges and for which it elects to apply hedge accounting. Hedge accounting disclosures shall provide information about:

(a) An entity's risk management strategy and how it is applied to manage risk;

(b) How the entity's hedging activities may affect the amount, timing and uncertainty of its future cash flows; and

(c) The effect that hedge accounting has had on the entity's statement of financial position, statement of comprehensive revenue and expense and statement of changes in net assets/equity.

*25B. An entity shall present the required disclosures in a single note or separate section in its financial statements. However, an entity need not duplicate information that is already presented elsewhere, provided that the information is incorporated by cross-reference from the financial statements to some other statement, such as a management commentary or risk report, that is available to users of the financial statements on the same terms as the financial statements and at the same time. Without the information incorporated by cross-reference, the financial statements are incomplete.

*25C. When paragraphs 26A–28F require the entity to separate by risk category the information disclosed, the entity shall determine each risk category on the basis of the risk exposures an entity decides to hedge and for which hedge accounting is applied. An entity shall determine risk categories consistently for all hedge accounting disclosures.

25D. To meet the objectives in paragraph 25A, an entity shall (except as otherwise specified below) determine how much detail to disclose, how much emphasis to place on different aspects of the disclosure requirements, the appropriate level of aggregation or disaggregation, and whether users of financial statements need additional explanations to evaluate the quantitative information disclosed. However, an entity shall use the same level of aggregation or disaggregation it uses for disclosure requirements of related information in this Standard.

The Risk Management Strategy

26. [Deleted by IPSASB] ~~An entity shall disclose the following separately for each type of hedge described in PBE IPSAS 29 (i.e., fair value hedges, cash flow hedges, and hedges of net investments in foreign operations):~~

~~(a) A description of each type of hedge;~~

~~(b) A description of the financial instruments designated as hedging instruments and their fair values at the end of the reporting period; and~~

~~(c) The nature of the risks being hedged.~~

26A. An entity shall explain its risk management strategy for each risk category of risk exposures that it decides to hedge and for which hedge accounting is applied. This explanation should enable users of financial statements to evaluate (for example):

(a) How each risk arises.

(b) How the entity manages each risk; this includes whether the entity hedges an item in its entirety for all risks or hedges a risk component (or components) of an item and why.

(c) The extent of risk exposures that the entity manages.

26B. To meet the requirements in paragraph 26A, the information should include (but is not limited to) a description of:

(a) The hedging instruments that are used (and how they are used) to hedge risk exposures;

(b) How the entity determines the economic relationship between the hedged item and the hedging instrument for the purpose of assessing hedge effectiveness; and

(c) How the entity establishes the hedge ratio and what the sources of hedge ineffectiveness are.

26C. When an entity designates a specific risk component as a hedged item (see paragraph 128 of PBE IPSAS 41) it shall provide, in addition to the disclosures required by paragraphs 26A and 26B, qualitative or quantitative information about:

(a) How the entity determined the risk component that is designated as the hedged item (including a description of the nature of the relationship between the risk component and the item as a whole); and

(b) How the risk component relates to the item in its entirety (for example, the designated risk component historically covered on average 80 percent of the changes in fair value of the item as a whole).

The Amount, Timing and Uncertainty of Future Cash Flows

27. [Deleted by IPSASB] ~~For cash flow hedges, an entity shall disclose:~~

~~(a) The periods when the cash flows are expected to occur and when they are expected to affect surplus or deficit;~~

~~(b) A description of any forecast transaction for which hedge accounting had previously been used, but which is no longer expected to occur;~~

~~(c) The amount that was recognised in other comprehensive revenue and expense during the period;~~

~~(d) The amount that was reclassified from net assets/equity to surplus or deficit for the period, showing the amount included in each line item in the statement of comprehensive revenue and expense; and~~

~~(e) The amount that was removed from net assets/equity during the period and included in the initial cost or other carrying amount of a non-financial asset or non-financial liability whose acquisition or incurrence was a hedged highly probable forecast transaction.~~

RDR 27.1 [Deleted by NZASB] ~~A Tier 2 entity is required to show only the total amount of cash flow hedges reclassified from net assets/equity and included in surplus or deficit for the period in accordance with paragraph 27(d).~~

*27A. Unless exempted by paragraph 27C, an entity shall disclose by risk category quantitative information to allow users of its financial statements to evaluate the terms and conditions of hedging instruments and how they affect the amount, timing and uncertainty of future cash flows of the entity.

*27B. To meet the requirement in paragraph 27A, an entity shall provide a breakdown that discloses:

(a) A profile of the timing of the nominal amount of the hedging instrument; and

(b) If applicable, the average price or rate (for example strike or forward prices etc) of the hedging instrument.

27C. In situations in which an entity frequently resets (i.e., discontinues and restarts) hedging relationships because both the hedging instrument and the hedged item frequently change (i.e., the entity uses a dynamic process in which both the exposure and the hedging instruments used to manage that exposure do not remain the same for long—such as in the example in paragraph AG317(b) of PBE IPSAS 41) the entity:

*(a) Is exempt from providing the disclosures required by paragraphs 27A and 27B.

(b) Shall disclose:

(i) Information about what the ultimate risk management strategy is in relation to those hedging relationships;

(ii) A description of how it reflects its risk management strategy by using hedge accounting and designating those particular hedging relationships; and

(iii) An indication of how frequently the hedging relationships are discontinued and restarted as part of the entity's process in relation to those hedging relationships.

*27D. An entity shall disclose by risk category a description of the sources of hedge ineffectiveness that are expected to affect the hedging relationship during its term.

*27E. If other sources of hedge ineffectiveness emerge in a hedging relationship, an entity shall disclose those sources by risk category and explain the resulting hedge ineffectiveness.

27F. For cash flow hedges, an entity shall disclose a description of any forecast transaction for which hedge accounting had been used in the previous period, but which is no longer expected to occur.

The Effects of Hedge Accounting on Financial Position and Performance

28. [Deleted by IPSASB] ~~An entity shall disclose separately:~~

~~(a) In fair value hedges, gains or losses:~~

~~(i) On the hedging instrument; and~~

~~(ii) On the hedged item attributable to the hedged risk.~~

~~(b) The ineffectiveness recognised in surplus or deficit that arises from cash flow hedges; and~~

~~(c) The ineffectiveness recognised in surplus or deficit that arises from hedges of net investments in foreign operations.~~

28A. An entity shall disclose, in a tabular format, the following amounts related to items designated as hedging instruments separately by risk category for each type of hedge (fair value hedge, cash flow hedge or hedge of a net investment in a foreign operation):

(a) The carrying amount of the hedging instruments (financial assets separately from financial liabilities);

*(b) The line item in the statement of financial position that includes the hedging instrument;

(c) The change in fair value of the hedging instrument used as the basis for recognising hedge ineffectiveness for the period; and

*(d) The nominal amounts (including quantities such as tonnes or cubic metres) of the hedging instruments.

RDR 28A.1. A Tier 2 entity is not required to make the disclosures required by paragraph 28A in a tabular format.

28B. An entity shall disclose, in a tabular format, the following amounts related to hedged items separately by risk category for the types of hedges as follows:

(a) For fair value hedges:

(i) The carrying amount of the hedged item recognised in the statement of financial position (presenting assets separately from liabilities);

*(ii) The accumulated amount of fair value hedge adjustments on the hedged item included in the carrying amount of the hedged item recognised in the statement of financial position (presenting assets separately from liabilities);

*(iii) The line item in the statement of financial position that includes the hedged item;

(iv) The change in value of the hedged item used as the basis for recognising hedge ineffectiveness for the period; and

*(v) The accumulated amount of fair value hedge adjustments remaining in the statement of financial position for any hedged items that have ceased to be adjusted for hedging gains and losses in accordance with paragraph 139 of PBE IPSAS 41.

(b) For cash flow hedges and hedges of a net investment in a foreign operation:

(i) The change in value of the hedged item used as the basis for recognising hedge ineffectiveness for the period (i.e., for cash flow hedges the change in value used to determine the recognised hedge ineffectiveness in accordance with paragraph 140(c) of PBE IPSAS 41);

*(ii) The balances in the cash flow hedge reserve and the foreign currency translation reserve for continuing hedges that are accounted for in accordance with paragraphs 140 and 142(a) of PBE IPSAS 41; and

*(iii) The balances remaining in the cash flow hedge reserve and the foreign currency translation reserve from any hedging relationships for which hedge accounting is no longer applied.

RDR 28B.1. A Tier 2 entity is not required to make the disclosures required by paragraph 28B in a tabular format.

28C. An entity shall disclose, in a tabular format, the following amounts separately by risk category for the types of hedges as follows:

(a) For fair value hedges:

(i) Hedge ineffectiveness—i.e., the difference between the hedging gains or losses of the hedging instrument and the hedged item—recognised in surplus or deficit (or other comprehensive revenue and expense for hedges of an equity instrument for which an entity has elected to present changes in fair value in other comprehensive revenue and expense in accordance with paragraph 106 of PBE IPSAS 41); and

*(ii) The line item in the statement of comprehensive revenue and expense that includes the recognised hedge ineffectiveness.

(b) For cash flow hedges and hedges of a net investment in a foreign operation:

(i) Hedging gains or losses of the reporting period that were recognised in other comprehensive revenue and expense;

(ii) Hedge ineffectiveness recognised in surplus or deficit;

*(iii) The line item in the statement of comprehensive revenue and expense that includes the recognised hedge ineffectiveness;

(iv) The amount reclassified from the cash flow hedge reserve or the foreign currency translation reserve into surplus or deficit as a reclassification adjustment (see PBE IPSAS 1) (differentiating between amounts for which hedge accounting had previously been used, but for which the hedged future cash flows are no longer expected to occur, and amounts that have been transferred because the hedged item has affected surplus or deficit);

*(v) The line item in the statement of comprehensive revenue and expense that includes the reclassification adjustment (see PBE IPSAS 1); and

(vi) For hedges of net positions, the hedging gains or losses recognised in a separate line item in the statement of comprehensive revenue and expense (see paragraph 149 of PBE IPSAS 41).

RDR 28C.1. A Tier 2 entity is not required to make the disclosures required by paragraph 28C in a tabular format.

RDR 28C.2. A Tier 2 entity is required to disclose only the amount reclassified from the cash flow hedge reserve or the foreign currency translation reserve into surplus or deficit as a reclassification adjustment in accordance with paragraph 28C(b)(iv).

*28D. When the volume of hedging relationships to which the exemption in paragraph 27C applies is unrepresentative of normal volumes during the period (i.e., the volume at the reporting date does not reflect the volumes during the period) an entity shall disclose that fact and the reason it believes the volumes are unrepresentative.

*28E. An entity shall provide a reconciliation of each component of net assets/equity and an analysis of other comprehensive revenue and expense in accordance with PBE IPSAS 1 that, taken together:

(a) Differentiates, at a minimum, between the amounts that relate to the disclosures in paragraph 28C(b)(i) and (b)(iv) as well as the amounts accounted for in accordance with paragraph 140(d)(i) and (d)(iii) of PBE IPSAS 41;

(b) Differentiates between the amounts associated with the time value of options that hedge transaction related hedged items and the amounts associated with the time value of options that hedge time-period related hedged items when an entity accounts for the time value of an option in accordance with paragraph 144 of PBE IPSAS 41; and

(c) Differentiates between the amounts associated with forward elements of forward contracts and the foreign currency basis spreads of financial instruments that hedge transaction related hedged items, and the amounts associated with forward elements of forward contracts and the foreign currency basis spreads of financial instruments that hedge time-period related hedged items when an entity accounts for those amounts in accordance with paragraph 145 of PBE IPSAS 41.

*28F. An entity shall disclose the information required in paragraph 28E separately by risk category. This disaggregation by risk may be provided in the notes to the financial statements.

Option to Designate a Credit Exposure as Measured at Fair Value Through Surplus or Deficit

28G. If an entity designated a financial instrument, or a proportion of it, as measured at fair value through surplus or deficit because it uses a credit derivative to manage the credit risk of that financial instrument it shall disclose:

*(a) For credit derivatives that have been used to manage the credit risk of financial instruments designated as measured at fair value through surplus or deficit in accordance with paragraph 152 of PBE IPSAS 41, a reconciliation of each of the nominal amount and the fair value at the beginning and at the end of the period;

*(b) The gain or loss recognised in surplus or deficit on designation of a financial instrument, or a proportion of it, as measured at fair value through surplus or deficit in accordance with paragraph 152 of PBE IPSAS 41; and

(c) On discontinuation of measuring a financial instrument, or a proportion of it, at fair value through surplus or deficit, that financial instrument's fair value that has become the new carrying amount in accordance with paragraph 155 of PBE IPSAS 41and the related nominal or principal amount (except for providing comparative information in accordance with PBE IPSAS 1, an entity does not need to continue this disclosure in subsequent periods).

…

*34. If the market for a financial instrument is not active, an entity establishes its fair value using a valuation technique (see paragraph~~s~~ AG149–AG154 of PBE IPSAS 41~~AG106–AG112 of PBE IPSAS 29~~). Nevertheless, the best evidence of fair value at initial recognition is the transaction price (i.e., the fair value of the consideration given or received), unless conditions described in paragraph AG151 of PBE IPSAS 41 ~~AG108 of PBE IPSAS 29~~ are met. It follows that there could be a difference between the fair value at initial recognition and the amount that would be determined at that date using the valuation technique. If such a difference exists, an entity shall disclose, by class of financial instrument:

~~*~~(a) Its accounting policy for recognising that difference in surplus or deficit to reflect a change in factors (including time) that market participants would consider in setting a price (see paragraph AG117(b) of PBE IPSAS 41~~AG109 of PBE IPSAS 29~~); and

~~*~~(b) The aggregate difference yet to be recognised in surplus or deficit at the beginning and end of the period and a reconciliation of changes in the balance of this difference.

35. Disclosures of fair value are not required:

(a) When the carrying amount is a reasonable approximation of fair value, for example, for financial instruments such as short-term trade receivables and payables; and

(b) [Deleted by IPSASB] ~~For an investment in equity instruments that do not have a quoted market price in an active market, or derivatives linked to such equity instruments, that is measured at cost in accordance with PBE IPSAS 29 because its fair value cannot be measured reliably; and~~

(c) For a contract containing a discretionary participation feature if the fair value of that feature cannot be measured reliably.

36. In the case~~s~~ described in paragraph 35~~(b) and~~ (c), an entity shall disclose information to help users of the financial statements make their own judgements about the extent of possible differences between the carrying amount of those financial assets or financial liabilities and their fair value, including:

(a) …

Concessionary Loans

37. Concessionary loans are granted by entities on below market terms. Examples of concessionary loans granted by entities include loans to developing countries, small farms, student loans granted to qualifying students for university or college education, and housing loans granted to low income families. For concessionary loans granted and measured at amortised cost in accordance with paragraph 40 of PBE IPSAS 41, an entity shall disclose:

…

37A. For concessionary loans measured at fair value in accordance with paragraph 41 or 43 of PBE IPSAS 41 an entity shall disclose:

(a) A reconciliation between the opening and closing carrying amounts of the loans, including:

(i) Nominal value of new loans granted during the period;

(ii) The fair value adjustment on initial recognition;

(iii) Loans repaid during the period;

(iv) The fair value adjustment during the period (separate from initial recognition); and

(vi) Other changes.

(b) Nominal value of the loans at the end of the period;

(c) The purpose and terms of the various types of loans, including the nature of the concession; and

(d) Valuation assumptions.

…

Nature and Extent of Risks Arising from Financial Instruments

…

*39A. Providing qualitative disclosures in the context of quantitative disclosures enables users to link related disclosures and hence form an overall picture of the nature and extent of risks arising from financial instruments. The interaction between qualitative and quantitative disclosures contributes to disclosure of information in a way that better enables users to evaluate an entity's exposure to risks.

…

Quantitative Disclosures

*41. For each type of risk arising from financial instruments, an entity shall disclose:

(a) Summary quantitative data about its exposure to that risk at the end of the reporting period. This disclosure shall be based on the information provided internally to key management personnel of the entity (as defined in PBE IPSAS 20 *Related Party Disclosures*), for example, the entity's governing body or chief executive officer.

(b) The disclosures required by paragraphs 43–49, to the extent not provided in accordance with (a)~~, unless the risk is not material (see paragraphs 45 47 of PBE IPSAS 1 for a discussion of materiality)~~.

(c) Concentrations of risk if not apparent from the disclosures made in accordance with (a) and (b).

…

Credit Risk

Scope and Objectives

*42A. An entity shall apply the disclosure requirements in paragraphs 42F–42N to financial instruments to which the impairment requirements in PBE IPSAS 41are applied. However:

(a) For receivables that result from exchange transactions that are within the scope of PBE IPSAS 9 and non-exchange transactions within the scope of PBE IPSAS 23 and lease receivables, paragraph 42J(a) applies to those receivables or lease receivables on which lifetime expected credit losses are recognised in accordance with paragraph 87 of PBE IPSAS 41, if those financial assets are modified while more than 30 days past due; and

(b) Paragraph 42K(b) does not apply to lease receivables.

*42B. The credit risk disclosures made in accordance with paragraphs 42F–42N shall enable users of financial statements to understand the effect of credit risk on the amount, timing and uncertainty of future cash flows. To achieve this objective, credit risk disclosures shall provide:

(a) Information about an entity's credit risk management practices and how they relate to the recognition and measurement of expected credit losses, including the methods, assumptions and information used to measure expected credit losses;

(b) Quantitative and qualitative information that allows users of financial statements to evaluate the amounts in the financial statements arising from expected credit losses, including changes in the amount of expected credit losses and the reasons for those changes; and

(c) Information about an entity's credit risk exposure (i.e., the credit risk inherent in an entity's financial assets and commitments to extend credit) including significant credit risk concentrations.

*42C. An entity need not duplicate information that is already presented elsewhere, provided that the information is incorporated by cross-reference from the financial statements to other statements, such as a management commentary or risk report that is available to users of the financial statements on the same terms as the financial statements and at the same time. Without the information incorporated by cross-reference, the financial statements are incomplete.

*42D. To meet the objectives in paragraph 42B, an entity shall (except as otherwise specified) consider how much detail to disclose, how much emphasis to place on different aspects of the disclosure requirements, the appropriate level of aggregation or disaggregation, and whether users of financial statements need additional explanations to evaluate the quantitative information disclosed.

*42E. If the disclosures provided in accordance with paragraphs 42F–42N are insufficient to meet the objectives in paragraph 42B, an entity shall disclose additional information that is necessary to meet those objectives.

The Credit Risk Management Practices

*42F. An entity shall explain its credit risk management practices and how they relate to the recognition and measurement of expected credit losses. To meet this objective an entity shall disclose information that enables users of financial statements to understand and evaluate:

(a) How an entity determined whether the credit risk of financial instruments has increased significantly since initial recognition, including, if and how:

(i) Financial instruments are considered to have low credit risk in accordance with paragraph 82 of PBE IPSAS 41, including the classes of financial instruments to which it applies; and

(ii) The presumption in paragraph 83 of PBE IPSAS 41, that there have been significant increases in credit risk since initial recognition when financial assets are more than 30 days past due, has been rebutted;

(b) An entity's definitions of default, including the reasons for selecting those definitions;

(c) How the instruments were grouped if expected credit losses were measured on a collective basis;

(d) How an entity determined that financial assets are credit-impaired financial assets;

(e) An entity's write-off policy, including the indicators that there is no reasonable expectation of recovery and information about the policy for financial assets that are written-off but are still subject to enforcement activity; and

(f) How the requirements in paragraph 84 of PBE IPSAS 41for the modification of contractual cash flows of financial assets have been applied, including how an entity:

(i) Determines whether the credit risk on a financial asset that has been modified while the loss allowance was measured at an amount equal to lifetime expected credit losses, has improved to the extent that the loss allowance reverts to being measured at an amount equal to 12-month expected credit losses in accordance with paragraph 77 of PBE IPSAS 41; and

(ii) Monitors the extent to which the loss allowance on financial assets meeting the criteria in (i) is subsequently remeasured at an amount equal to lifetime expected credit losses in accordance with paragraph 75 of PBE IPSAS 41.

*42G. An entity shall explain the inputs, assumptions and estimation techniques used to apply the requirements in paragraphs 73–93 of PBE IPSAS 41. For this purpose an entity shall disclose:

(a) The basis of inputs and assumptions and the estimation techniques used to:

(i) Measure the 12-month and lifetime expected credit losses;

(ii) Determine whether the credit risk of financial instruments has increased significantly since initial recognition; and

(iii) Determine whether a financial asset is a credit-impaired financial asset.

(b) How forward-looking information has been incorporated into the determination of expected credit losses, including the use of macroeconomic information; and

(c) Changes in the estimation techniques or significant assumptions made during the reporting period and the reasons for those changes.

Quantitative and Qualitative Information About Amounts Arising from Expected Credit Losses

*42H. To explain the changes in the loss allowance and the reasons for those changes, an entity shall provide, by class of financial instrument, a reconciliation from the opening balance to the closing balance of the loss allowance, in a table, showing separately the changes during the period for:

(a) The loss allowance measured at an amount equal to 12-month expected credit losses;

(b) The loss allowance measured at an amount equal to lifetime expected credit losses for:

(i) Financial instruments for which credit risk has increased significantly since initial recognition but that are not credit-impaired financial assets;

(ii) Financial assets that are credit-impaired at the reporting date (but that are not purchased or originated credit-impaired); and

(iii) Receivables that result from exchange transactions that are within the scope of PBE IPSAS 9 or non-exchange transactions that are within the scope of PBE IPSAS 23 or lease receivables for which the loss allowances are measured in accordance with paragraph 87 of PBE IPSAS 41.

(c) Financial assets that are purchased or originated credit-impaired. In addition to the reconciliation, an entity shall disclose the total amount of undiscounted expected credit losses at initial recognition on financial assets initially recognised during the reporting period.

*42I. To enable users of financial statements to understand the changes in the loss allowance disclosed in accordance with paragraph 42H, an entity shall provide an explanation of how significant changes in the gross carrying amount of financial instruments during the period contributed to changes in the loss allowance. The information shall be provided separately for financial instruments that represent the loss allowance as listed in paragraph 42H(a)–(c) and shall include relevant qualitative and quantitative information. Examples of changes in the gross carrying amount of financial instruments that contributed to the changes in the loss allowance may include:

(a) Changes because of financial instruments originated or acquired during the reporting period;

(b) The modification of contractual cash flows on financial assets that do not result in a derecognition of those financial assets in accordance with PBE IPSAS 41;

(c) Changes because of financial instruments that were derecognised (including those that were written-off) during the reporting period; and

(d) Changes arising from whether the loss allowance is measured at an amount equal to 12-month or lifetime expected credit losses.

*42J. To enable users of financial statements to understand the nature and effect of modifications of contractual cash flows on financial assets that have not resulted in derecognition and the effect of such modifications on the measurement of expected credit losses, an entity shall disclose:

(a) The amortised cost before the modification and the net modification gain or loss recognised for financial assets for which the contractual cash flows have been modified during the reporting period while they had a loss allowance measured at an amount equal to lifetime expected credit losses; and

(b) The gross carrying amount at the end of the reporting period of financial assets that have been modified since initial recognition at a time when the loss allowance was measured at an amount equal to lifetime expected credit losses and for which the loss allowance has changed during the reporting period to an amount equal to 12-month expected credit losses.

*42K. To enable users of financial statements to understand the effect of collateral and other credit enhancements on the amounts arising from expected credit losses, an entity shall disclose by class of financial instrument:

(a) The amount that best represents its maximum exposure to credit risk at the end of the reporting period without taking account of any collateral held or other credit enhancements (e.g., netting agreements that do not qualify for offset in accordance with PBE IPSAS 28).

(b) A narrative description of collateral held as security and other credit enhancements, including:

(i) A description of the nature and quality of the collateral held;

(ii) An explanation of any significant changes in the quality of that collateral or credit enhancements as a result of deterioration or changes in the collateral policies of the entity during the reporting period; and

(iii) Information about financial instruments for which an entity has not recognised a loss allowance because of the collateral.

(c) Quantitative information about the collateral held as security and other credit enhancements (for example, quantification of the extent to which collateral and other credit enhancements mitigate credit risk) for financial assets that are credit-impaired at the reporting date.

*42L. An entity shall disclose the contractual amount outstanding on financial assets that were written off during the reporting period and are still subject to enforcement activity.

Credit Risk Exposure

*42M. To enable users of financial statements to assess an entity's credit risk exposure and understand its significant credit risk concentrations, an entity shall disclose, by credit risk rating grades, the gross carrying amount of financial assets and the exposure to credit risk on loan commitments and financial guarantee contracts. This information shall be provided separately for financial instruments:

(a) For which the loss allowance is measured at an amount equal to 12-month expected credit losses;

(b) For which the loss allowance is measured at an amount equal to lifetime expected credit losses and that are:

(i) Financial instruments for which credit risk has increased significantly since initial recognition but that are not credit-impaired financial assets;

(ii) Financial assets that are credit-impaired at the reporting date (but that are not purchased or originated credit-impaired); and

(iii) Receivables that result from exchange transactions that are within the scope of PBE IPSAS 9 or non-exchange transactions that are within the scope of PBE IPSAS 23 or lease receivables for which the loss allowances are measured in accordance with paragraph 87 of PBE IPSAS 41.

(c) That are purchased or originated credit-impaired financial assets.

*42N. For receivables that result from exchange transactions that are within the scope of PBE IPSAS 9 or non-exchange transactions that are within the scope of PBE IPSAS 23 or lease receivables to which an entity applies paragraph 87 of PBE IPSAS 41, the information provided in accordance with paragraph 42M may be based on a provision matrix (see paragraph AG199 of PBE IPSAS 41).

*43. For all financial instruments within the scope of this Standard, but to which the impairment requirements in PBE IPSAS 41are not applied, an entity shall disclose by class of financial instrument:

(a) The amount that best represents its maximum exposure to credit risk at the end of the reporting period without taking account of any collateral held or other credit enhancements (e.g., netting agreements that do not qualify for offset in accordance with PBE IPSAS 28); this disclosure is not required for financial instruments whose carrying amount best represents the maximum exposure to credit risk.

(b) ~~In respect of the amount disclosed in (a), a~~A description of collateral held as security and other credit enhancements and their financial effect (e.g., quantification of the extent to which collateral and other credit enhancements mitigate credit risk) in respect of the amount that best represents the maximum exposure to credit risk (whether disclosed in accordance with (a) or represented by the carrying amount of a financial instrument).

(c) [Deleted by IPSASB]~~Information about the credit quality of financial assets that are neither past due nor impaired; and~~

(d) [Deleted by IPSASB]~~The carrying amount of financial assets that would otherwise be past due or impaired whose terms have been renegotiated.~~

~~**Financial Assets that are Either Past Due or Impaired**~~

~~*~~44. [Deleted by IPSASB]~~An entity shall disclose by class of financial asset:~~

~~(a) An analysis of the age of financial assets that are past due as at the end of the reporting period but not impaired;~~

~~(b) An analysis of financial assets that are individually determined to be impaired as at the end of the reporting period, including the factors the entity considered in determining that they are impaired; and~~

~~(c) For the amounts disclosed in (a) and (b), a description of collateral held by the entity as security and other credit enhancements and, unless impracticable, an estimate of their fair value.~~

Collateral and Other Credit Enhancements Obtained

*45. When an entity obtains financial or non-financial assets during the period by taking possession of collateral it holds as security or calling on other credit enhancements (e.g., guarantees), and such assets meet the recognition criteria in other Standards, an entity shall disclose for such assets held at the reporting date:

(a) The nature and carrying amount of the assets obtained; and

(b) When the assets are not readily convertible into cash, its policies for disposing of such assets or for using them in its operations.

…

Transfers of Financial Assets

49A. The disclosure requirements in paragraphs 49B–49H relating to transfers of financial assets supplement the other disclosure requirements of this Standard. An entity shall present the disclosures required by paragraphs 49B–49H in a single note in its financial statements. An entity shall provide the required disclosures for all transferred financial assets that are not derecognised and for any continuing involvement in a transferred asset, existing at the reporting date, irrespective of when the related transfer transaction occurred. For the purposes of applying the disclosure requirements in those paragraphs, an entity transfers all or a part of a financial asset (the transferred financial asset) if, and only if, it either:

(a) Transfers the contractual rights to receive the cash flows of that financial asset; or

(b) Retains the contractual rights to receive the cash flows of that financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients in an arrangement.

49B. An entity shall disclose information that enables users of its financial statements:

(a) To understand the relationship between transferred financial assets that are not derecognised in their entirety and the associated liabilities; and *(b) To evaluate the nature of, and risks associated with, the entity's continuing involvement in derecognised financial assets.

*49C. For the purposes of applying the disclosure requirements in paragraphs 49E–49H, an entity has continuing involvement in a transferred financial asset if, as part of the transfer, the entity retains any of the contractual rights or obligations inherent in the transferred financial asset or obtains any new contractual rights or obligations relating to the transferred financial asset. For the purposes of applying the disclosure requirements in paragraphs 49E–49H, the following do not constitute continuing involvement:

(a) Normal representations and warranties relating to fraudulent transfer and concepts of reasonableness, good faith and fair dealings that could invalidate a transfer as a result of legal action;

(b) Forward, option and other contracts to reacquire the transferred financial asset for which the contract price (or exercise price) is the fair value of the transferred financial asset; or

(c) An arrangement whereby an entity retains the contractual rights to receive the cash flows of a financial asset but assumes a contractual obligation to pay the cash flows to one or more entities and the conditions in paragraph 16(a)–(c) of PBE IPSAS 41 are met.

Transferred Financial Assets that are Not Derecognised in Their Entirety

49D. An entity may have transferred financial assets in such a way that part or all of the transferred financial assets do not qualify for derecognition. To meet the objectives set out in paragraph 49B(a), the entity shall disclose at each reporting date for each class of transferred financial assets that are not derecognised in their entirety:

(a) The nature of the transferred assets.

(b) The nature of the risks and rewards of ownership to which the entity is exposed.

(c) A description of the nature of the relationship between the transferred assets and the associated liabilities, including restrictions arising from the transfer on the reporting entity's use of the transferred assets.

*(d) When the counterparty (counterparties) to the associated liabilities has (have) recourse only to the transferred assets, a schedule that sets out the fair value of the transferred assets, the fair value of the associated liabilities and the net position (the difference between the fair value of the transferred assets and the associated liabilities).

*(e) When the entity continues to recognise all of the transferred assets, the carrying amounts of the transferred assets and the associated liabilities.

*(f) When the entity continues to recognise the assets to the extent of its continuing involvement (see paragraphs 17(c)(ii) and 27 of PBE IPSAS 41), the total carrying amount of the original assets before the transfer, the carrying amount of the assets that the entity continues to recognise, and the carrying amount of the associated liabilities.

RDR 42D.1 When a Tier 2 entity continues to recognise the assets to the extent of its continuing involvement (see paragraphs 17(c)(ii) and 27 of PBE IPSAS 41), the entity is required to disclose the carrying amount of the assets that the entity continues to recognise, and the carrying amount of the associated liabilities in accordance with paragraph 49D(f).

Transferred Financial Assets that are Derecognised in Their Entirety

49E. To meet the objectives set out in paragraph 49B(b), when an entity derecognises transferred financial assets in their entirety (see paragraph 17(a) and 17(c)(i) of PBE IPSAS 41) but has continuing involvement in them, the entity shall disclose, as a minimum, for each type of continuing involvement at each reporting date:

*(a) The carrying amount of the assets and liabilities that are recognised in the entity's statement of financial position and represent the entity's continuing involvement in the derecognised financial assets, and the line items in which the carrying amount of those assets and liabilities are recognised.

*(b) The fair value of the assets and liabilities that represent the entity's continuing involvement in the derecognised financial assets.

(c) The amount that best represents the entity's maximum exposure to loss from its continuing involvement in the derecognised financial assets, and information showing how the maximum exposure to loss is determined.

*(d) The undiscounted cash outflows that would or may be required to repurchase derecognised financial assets (e.g., the strike price in an option agreement) or other amounts payable to the transferee in respect of the transferred assets. If the cash outflow is variable then the amount disclosed should be based on the conditions that exist at each reporting date.

*(e) A maturity analysis of the undiscounted cash outflows that would or may be required to repurchase the derecognised financial assets or other amounts payable to the transferee in respect of the transferred assets, showing the remaining contractual maturities of the entity's continuing involvement.

*(f) Qualitative information that explains and supports the quantitative disclosures required in (a)–(e).

*49F. An entity may aggregate the information required by paragraph 49E in respect of a particular asset if the entity has more than one type of continuing involvement in that derecognised financial asset, and report it under one type of continuing involvement.

*49G. In addition, an entity shall disclose for each type of continuing involvement:

(a) The gain or loss recognised at the date of transfer of the assets.

(b) Revenue and expenses recognised, both in the reporting period and cumulatively, from the entity's continuing involvement in the derecognised financial assets (e.g. fair value changes in derivative instruments).

(c) If the total amount of proceeds from transfer activity (that qualifies for derecognition) in a reporting period is not evenly distributed throughout the reporting period (e.g. if a substantial proportion of the total amount of transfer activity takes place in the closing days of a reporting period):

(i) When the greatest transfer activity took place within that reporting period (e.g. the last five days before the end of the reporting period),

(ii) The amount (e.g., related gains or losses) recognised from transfer activity in that part of the reporting period, and

(iii) The total amount of proceeds from transfer activity in that part of the reporting period.

An entity shall provide this information for each period for which a statement of comprehensive revenue and expense is presented.

Supplementary Information

*49H. An entity shall disclose any additional information that it considers necessary to meet the disclosure objectives in paragraph 49B.

Initial Application of PBE IPSAS 41

Entities Transitioning from PBE IFRS 9

49H.1 Except as expressly permitted by PBE IPSAS 41, an entity that has previously applied PBE IFRS 9 shall not change the classification or measurement of its existing financial assets and financial liabilities on the date of initial application of PBE IPSAS 41.

49H.2 An entity that has previously applied PBE IFRS 9 shall comply with the requirements of this Standard, as amended by PBE IPSAS 41 when it applies PBE IPSAS 41 (see paragraph 53.7). The amended requirements need not be applied to comparative information provided before the date of initial application of PBE IFRS 9. However, the amended requirements in paragraphs 49A–49H and AG31–AG41 need not be applied to comparative information provided for periods before the date of initial application of PBE IPSAS 41.

Entities Transitioning from PBE IPSAS 29

49H.3 An entity that has not previously applied PBE IFRS 9 shall comply with the requirements of this Standard, as amended by PBE IPSAS 41 when it applies PBE IPSAS 41 (see paragraph 53.7). The amended requirements need not be applied to comparative information provided for periods before the date of initial application of PBE IPSAS 41.

49I. In the reporting period that includes the date of initial application of PBE IPSAS 41, an entity shall disclose the following information for each class of financial assets and financial liabilities as at the date of initial application:

(a) The original measurement category and carrying amount determined in accordance with PBE IPSAS 29;

(b) The new measurement category and carrying amount determined in accordance with PBE IPSAS 41;

(c) The amount of any financial assets and financial liabilities in the statement of financial position that were previously designated as measured at fair value through surplus or deficit but are no longer so designated, distinguishing between those that PBE IPSAS 41 requires an entity to reclassify and those that an entity elects to reclassify at the date of initial application.

49J. In the reporting period that includes the date of initial application of PBE IPSAS 41, an entity shall disclose qualitative information to enable users to understand:

(a) How it applied the classification requirements in PBE IPSAS 41 to those financial assets whose classification has changed as a result of applying PBE IPSAS 41.

(b) The reasons for any designation or de-designation of financial assets or financial liabilities as measured at fair value through surplus or deficit at the date of initial application.

49K. In the reporting period that an entity first applies the classification and measurement requirements for financial assets in PBE IPSAS 41 (i.e., when the entity transitions from PBE IPSAS 29 to PBE IPSAS 41 for financial assets), it shall present the disclosures set out in paragraphs 49L–49O of this Standard as required by paragraph 173 of PBE IPSAS 41.

49L. When required by paragraph 49K, an entity shall disclose the changes in the classifications of financial assets and financial liabilities as at the date of initial application of PBE IPSAS 41, showing separately:

(a) The changes in the carrying amounts on the basis of their measurement categories in accordance with PBE IPSAS 29 (i.e., not resulting from a change in measurement attribute on transition to PBE IPSAS 41); and

(b) The changes in the carrying amounts arising from a change in measurement attribute on transition to PBE IPSAS 41.

The disclosures in this paragraph need not be made after the annual reporting period in which the entity initially applies the classification and measurement requirements for financial assets in PBE IPSAS 41.

49M. When required by paragraph 49K, an entity shall disclose the following for financial assets and financial liabilities that have been reclassified so that they are measured at amortised cost and, in the case of financial assets, that have been reclassified out of fair value through surplus or deficit so that they are measured at fair value through other comprehensive revenue and expense, as a result of the transition to PBE IPSAS 41:

(a) The fair value of the financial assets or financial liabilities at the end of the reporting period; and

(b) The fair value gain or loss that would have been recognised in surplus or deficit or other comprehensive revenue and expense during the reporting period if the financial assets or financial liabilities had not been reclassified.

The disclosures in this paragraph need not be made after the annual reporting period in which the entity initially applies the classification and measurement requirements for financial assets in PBE IPSAS 41.

49N. When required by paragraph 49K, an entity shall disclose the following for financial assets and financial liabilities that have been reclassified out of the fair value through surplus or deficit category as a result of the transition to PBE IPSAS 41:

(a) The effective interest rate determined on the date of initial application; and

(b) The interest revenue or expense recognised.

If an entity treats the fair value of a financial asset or a financial liability as the new gross carrying amount at the date of initial application (see paragraph 168 of PBE IPSAS 41), the disclosures in this paragraph shall be made for each reporting period until derecognition. Otherwise, the disclosures in this paragraph need not be made after the annual reporting period in which the entity initially applies the classification and measurement requirements for financial assets in PBE IPSAS 41.

49O. When an entity presents the disclosures set out in paragraphs 49K–49N, those disclosures, and the disclosures in paragraph 29 of this Standard, must permit reconciliation between:

(a) The measurement categories presented in accordance with PBE IPSAS 29 and PBE IPSAS 41; and

(b) The class of financial instrument

as at the date of initial application.

49P. On the date of initial application of paragraphs 73–93 of PBE IPSAS 41, an entity is required to disclose information that would permit the reconciliation of the ending impairment allowances in accordance with PBE IPSAS 29 and the provisions in accordance with PBE IPSAS 19 to the opening loss allowances determined in accordance with PBE IPSAS 41. For financial assets, this disclosure shall be provided by the related financial assets' measurement categories in accordance with PBE IPSAS 29 and PBE IPSAS 41, and shall show separately the effect of the changes in the measurement category on the loss allowance at that date.

49Q. In the reporting period that includes the date of initial application of PBE IPSAS 41, an entity is not required to disclose the line item amounts that would have been reported in accordance with the classification and measurement requirements (which includes the requirements related to amortised cost measurement of financial assets and impairment in paragraphs 69–72 and 73–93 of PBE IPSAS 41) of:

(a) PBE IPSAS 41 for prior periods; and

(b) PBE IPSAS 29 for the current period.

49R. In accordance with paragraph 161 of PBE IPSAS 41, if it is impracticable (as defined in PBE IPSAS 3) at the date of initial application of PBE IPSAS 41 for an entity to assess a modified time value of money element in accordance with paragraphs AG68–AG70 of PBE IPSAS 41 based on the facts and circumstances that existed at the initial recognition of the financial asset, an entity shall assess the contractual cash flow characteristics of that financial asset based on the facts and circumstances that existed at the initial recognition of the financial asset without taking into account the requirements related to the modification of the time value of money element in paragraphs AG68–AG70 of PBE IPSAS 41. An entity shall disclose the carrying amount at the reporting date of the financial assets whose contractual cash flow characteristics have been assessed based on the facts and circumstances that existed at the initial recognition of the financial asset without taking into account the requirements related to the modification of the time value of money element in paragraphs AG68–AG70 of PBE IPSAS 41 until those financial assets are derecognised.

49S. In accordance with paragraph 162 of PBE IPSAS 41, if it is impracticable (as defined in PBE IPSAS 3) at the date of initial application for an entity to assess whether the fair value of a prepayment feature was insignificant in accordance with paragraphs AG74(c) of PBE IPSAS 41 based on the facts and circumstances that existed at the initial recognition of the financial asset, an entity shall assess the contractual cash flow characteristics of that financial asset based on the facts and circumstances that existed at the initial recognition of the financial asset without taking into account the exception for prepayment features in paragraph AG74 of PBE IPSAS 41. An entity shall disclose the carrying amount at the reporting date of the financial assets whose contractual cash flow characteristics have been assessed based on the facts and circumstances that existed at the initial recognition of the financial asset without taking into account the exception for prepayment features in paragraph AG74 of PBE IPSAS 41 until those financial assets are derecognised.

…

53.5 **PBE IFRS 9 *Financial Instruments*, issued in January 2017, amended paragraphs 2–5, 8, 11, RDR 11.1, 12–14, 17, 18, 24, RDR 24.1, 34–37, and 43, deleted paragraphs 15–16, 20, 26, 27, RDR27.1, 28, 44 and one heading and added paragraphs 14A–14B, 16A–16D, 20A, 24A, 25A–25D, 26A–26C, 27A–27F, 28A–28F, 28G, 42A–42E, 42F–42G, 42M–42N, 49I–49S and several headings. An entity shall apply those amendments when it applies PBE IFRS 9. Those amendments need not**

be applied to comparative information provided for periods before the date of initial application of PBE IFRS 9.*

* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.

…

53.7 **PBE IPSAS 41, issued in March 2019, amended paragraphs 2–5, 8, 11, RDR 11.1, 12–13, 14, 18, 24, RDR 24.1, 34–37, 43, 45, 53.5, AG1, AG5, AG9, AG10, AG24 and AG27, added paragraphs 5A, 13A, 14A–14B, 15A–15C, 17A–17F, 20A, 24A, 25A–25D, 26A–26C, 27A–27F, 28A–28F, 28G, 37A, 39A, 42A–42N, 49A–49S, AG8A–AG8J and related headings, and deleted paragraphs RDR 11.2, 15–17, 20, 26, 27, RDR 27.1, 28, 44 and AG4 (and the heading preceding paragraph 17).**

In the Application Guidance, paragraphs AG1, AG5, AG9, AG10, AG24 and AG27 are amended. Paragraphs AG8A–AG8J and related headings are added. Paragraph AG4 and the related headings are deleted. New text is underlined and deleted text is struck through.

Application Guidance

This Appendix is an integral part of PBE IPSAS 30.

Classes of Financial Instruments and Level of Disclosure (paragraph 9)

*AG1. Paragraph 9 requires an entity to group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. The classes described in paragraph 9 are determined by the entity and are, thus, distinct from the categories of financial instruments specified in ~~PBE IPSAS 29~~ PBE IPSAS 41 *Financial Instruments* (which determine how financial instruments are measured and where changes in fair value are recognised).

…

~~**Significance of Financial Instruments for Financial Position and Financial Performance**~~

~~*Financial Liabilities at Fair Value through Surplus or Deficit (paragraphs 13 and 14)*~~

~~*~~AG4. [Deleted by IPSASB]~~If an entity designates a financial liability as at fair value through surplus or deficit, paragraph 13(a) requires it to disclose the amount of change in the fair value of the financial liability that is attributable to changes in the liability's credit risk. Paragraph 13(a)(i) permits an entity to determine this amount as the amount of change in the liability's fair value that is not attributable to changes in market conditions that give rise to market risk. If the only relevant changes in market conditions for a liability are changes in an observed (benchmark) interest rate, this amount can be estimated as follows:~~

~~(a) First, the entity computes the liability's internal rate of return at the start of the period using the observed market price of the liability and the liability's contractual cash flows at the start of the period. It deducts from this rate of return the observed (benchmark) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.~~

~~(b) Next, the entity calculates the present value of the cash flows associated with the liability using the liability's contractual cash flows at the end of the period and a discount rate equal to the sum of (i) the observed (benchmark) interest rate at the end of the period, and (ii) the instrument-specific component of the internal rate of return as determined in (a).~~

~~(c) The difference between the observed market price of the liability at the end of the period and the amount determined in (b) is the change in fair value that is not attributable to changes in the observed (benchmark) interest rate. This is the amount to be disclosed.~~

~~This example assumes that changes in fair value arising from factors other than changes in the instrument's credit risk or changes in interest rates are not significant. If the instrument in the example contains an embedded derivative, the change in fair value of the embedded derivative is excluded in determining the amount to be disclosed in accordance with paragraph 13(a).~~

Other Disclosure—Accounting Policies (paragraph 25)

AG5. Paragraph 25 requires disclosure of the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements. For financial instruments, such disclosure may include:

(a) For ~~financial assets or~~ financial liabilities designated as at fair value through surplus or deficit:

(i) The nature of the ~~financial assets or~~ financial liabilities the entity has designated as at fair value through surplus or deficit;

(ii) The criteria for so designating such ~~financial assets or~~ financial liabilities on initial recognition; and

(iii) How the entity has satisfied the conditions in paragraphs 46 ~~10, 13, or 14~~ of ~~PBE IPSAS 29~~ PBE IPSAS 41 for such designation. ~~For instruments designated in accordance with paragraph (b)(i) of the definition of a financial asset or financial liability at fair value through surplus or deficit in PBE IPSAS 29, that disclosure includes a narrative description of the circumstances underlying the measurement or recognition inconsistency that would otherwise arise. For instruments designated in accordance with paragraph (b)(ii) of the definition of a financial asset or financial liability at fair value through surplus or deficit in PBE IPSAS 29, that disclosure includes a narrative description of how designation at fair value through surplus or deficit is consistent with the entity's documented risk management or investment strategy~~.

(b) ~~The criteria for designating financial assets as available for sale.~~ For financial assets designated as measured at fair value through surplus or deficit:

(i) The nature of the financial assets the entity has designated as measured at fair value through surplus or deficit; and

(ii) How the entity has satisfied the criteria in paragraph 44 of PBE IPSAS 41 for such designation.

(c) Whether regular way purchases and sales of financial assets are accounted for at trade date or at settlement date (see paragraph ~~40 of PBE IPSAS 29~~ 11 of PBE IPSAS 41).

(d) [Deleted by IPSASB]~~When an allowance account is used to reduce the carrying amount of financial assets impaired by credit losses:~~

~~(i) The criteria for determining when the carrying amount of impaired financial assets is reduced directly (or, in the case of a reversal of a write-down, increased directly) and when the allowance account is used; and~~

~~(ii) The criteria for writing off amounts charged to the allowance account against the carrying amount of impaired financial assets (see paragraph 20).~~

(e) How net gains or net losses on each category of financial instrument are determined (see paragraph 24(a)), for example, whether the net gains or net losses on items at fair value through surplus or deficit include interest or revenue from dividends or similar distributions.

(f)–(g) [Deleted by IPSASB]~~The criteria the entity uses to determine that there is objective evidence that an impairment loss has occurred (see paragraph 24(e)).~~

~~(g) When the terms of financial assets that would otherwise be past due or impaired have been renegotiated, the accounting policy for financial assets that are the subject of renegotiated terms (see paragraph 43(d)).~~

(h) For financial guarantee contracts issued through a non-exchange transaction, where no fair value can be determined ~~and a provision is recognised in accordance with PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*~~, disclosure of the ~~circumstances that result in a provision being recognised~~ reasons why fair value was not determinable.

Paragraph 137 of PBE IPSAS 1 also requires entities to disclose, in the summary of ~~along with its~~ significant accounting policies or other notes, the judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

…

Credit Risk Management Practices (paragraphs 42F–42G)

*AG8A. Paragraph 42F(b) requires the disclosure of information about how an entity has defined default for different financial instruments and the reasons for selecting those definitions. In accordance with paragraph 81 of PBE IPSAS 41, the determination of whether lifetime expected credit losses should be recognised is based on the increase in the risk of a default occurring since initial recognition. Information about an entity's definitions of default that will assist users of financial statements in understanding how an entity has applied the expected credit loss requirements in PBE IPSAS 41 may include:

(a) The qualitative and quantitative factors considered in defining default;

(b) Whether different definitions have been applied to different types of financial instruments; and

(c) Assumptions about the cure rate (i.e., the number of financial assets that return to a performing status) after a default occurred on the financial asset.

*AG8B. To assist users of financial statements in evaluating an entity's restructuring and modification policies, paragraph 42F(f)(ii) requires the disclosure of information about how an entity monitors the extent to which the loss allowance on financial assets previously disclosed in accordance with paragraph 42F(f)(i) are subsequently measured at an amount equal to lifetime expected credit losses in accordance with paragraph 75 of PBE IPSAS 41. Quantitative information that will assist users in understanding the subsequent increase in credit risk of modified financial assets may include information about modified financial assets meeting the criteria in paragraph 42F(f)(i) for which the loss allowance has reverted to being measured at an amount equal to lifetime expected credit losses (i.e., a deterioration rate).

*AG8C. Paragraph 42G(a) requires the disclosure of information about the basis of inputs and assumptions and the estimation techniques used to apply the impairment requirements in PBE IPSAS 41. An entity's assumptions and inputs used to measure expected credit losses or determine the extent of increases in credit risk since initial recognition may include information obtained from internal historical information or rating reports and assumptions about the expected life of financial instruments and the timing of the sale of collateral.

Changes in the Loss Allowance (paragraph 42H)

*AG8D. In accordance with paragraph 42H, an entity is required to explain the reasons for the changes in the loss allowance during the period. In addition to the reconciliation from the opening balance to the closing balance of the loss allowance, it may be necessary to provide a narrative explanation of the changes. This narrative explanation may include an analysis of the reasons for changes in the loss allowance during the period, including:

(a) The portfolio composition;

(b) The volume of financial instruments purchased or originated; and

(c) The severity of the expected credit losses.

*AG8E. For loan commitments and financial guarantee contracts the loss allowance is recognised as a provision. An entity should disclose information about the changes in the loss allowance for financial assets separately from those for loan commitments and financial guarantee contracts. However, if a financial instrument includes both a loan (i.e., financial asset) and an undrawn commitment (i.e., loan commitment) component and the entity cannot separately identify the expected credit losses on the loan commitment component from those on the financial asset component, the expected credit losses on the loan commitment should be recognised together with the loss allowance for the financial asset. To the extent that the combined expected credit losses exceed the gross carrying amount of the financial asset, the expected credit losses should be recognised as a provision.

Collateral (paragraph 42K)

*AG8F. Paragraph 42K requires the disclosure of information that will enable users of financial statements to understand the effect of collateral and other credit enhancements on the amount of expected credit losses.

An entity is neither required to disclose information about the fair value of collateral and other credit enhancements nor is it required to quantify the exact value of the collateral that was included in the calculation of expected credit losses (i.e., the loss given default).

*AG8G. A narrative description of collateral and its effect on amounts of expected credit losses might include information about:

(a) The main types of collateral held as security and other credit enhancements (examples of the latter being guarantees, credit derivatives and netting agreements that do not qualify for offset in accordance with PBE IPSAS 28);

(b) The volume of collateral held and other credit enhancements and its significance in terms of the loss allowance;

(c) The policies and processes for valuing and managing collateral and other credit enhancements;

(d) The main types of counterparties to collateral and other credit enhancements and their creditworthiness; and

(e) Information about risk concentrations within the collateral and other credit enhancements.

Credit Risk Exposure (paragraphs 42M–42N)

*AG8H. Paragraph 42M requires the disclosure of information about an entity's credit risk exposure and significant concentrations of credit risk at the reporting date. A concentration of credit risk exists when a number of counterparties are located in a geographical region or are engaged in similar activities and have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. An entity should provide information that enables users of financial statements to understand whether there are groups or portfolios of financial instruments with particular features that could affect a large portion of that group of financial instruments such as concentration to particular risks. This could include, for example, loan-to-value groupings, geographical, industry or issuer-type concentrations.

*AG8I. The number of credit risk rating grades used to disclose the information in accordance with paragraph 42M shall be consistent with the number that the entity reports to key management personnel for credit risk management purposes. If past due information is the only borrower-specific information available and an entity uses past due information to assess whether credit risk has increased significantly since initial recognition in accordance with paragraph 82 of PBE IPSAS 41, an entity shall provide an analysis by past due status for those financial assets.

*AG8J. When an entity has measured expected credit losses on a collective basis, the entity may not be able to allocate the gross carrying amount of individual financial assets or the exposure to credit risk on loan commitments and financial guarantee contracts to the credit risk rating grades for which lifetime expected credit losses are recognised. In that case, an entity should apply the requirement in paragraph 42M to those financial instruments that can be directly allocated to a credit risk rating grade and disclose separately the gross carrying amount of financial instruments for which lifetime expected credit losses have been measured on a collective basis.

Maximum Credit Risk Exposure (paragraph 43(a))

~~*~~AG9. Paragraphs ~~43(a)~~ 42K(a) and 43(a) require~~s~~ disclosure of the amount that best represents the entity's maximum exposure to credit risk. For a financial asset, this is typically the gross carrying amount, net of:

(a) Any amounts offset in accordance with PBE IPSAS 28; and

(b) Any ~~impairment losses~~ loss allowance recognised in accordance with ~~PBE IPSAS 29~~ PBE IPSAS 41.

*AG10. Activities that give rise to credit risk and the associated maximum exposure to credit risk include, but are not limited to:

(a) Granting loans ~~and receivables~~ to customers and placing deposits with other entities. In these cases, the maximum exposure to credit risk is the carrying amount of the related financial assets.

…

*AG24. Interest rate risk arises on interest-bearing financial instruments recognised in the statement of financial position (e.g., ~~loans and receivables and~~ debt instruments acquired or issued) and on some financial instruments not recognised in the statement of financial position (e.g., some loan commitments).

…

*AG29. In accordance with paragraph 47(a), the sensitivity of surplus or deficit (that arises, for example, from instruments ~~classified as~~ measured at fair value through surplus or deficit ~~and impairments of available-for-sale financial assets~~) is disclosed separately from the sensitivity of other comprehensive revenue and expense ~~net assets/equity~~ (that arises, for example, from ~~instruments classified as available for sale~~ investments in equity instruments whose changes in fair value are presented in other comprehensive revenue and expense).

…

Derecognition (paragraphs 49C–49H)

Continuing Involvement (paragraph 49C)

*AG31. The assessment of continuing involvement in a transferred financial asset for the purposes of the disclosure requirements in paragraphs 49E–49H is made at the level of the reporting entity. For example, if a controlled entity transfers to an unrelated third party a financial asset in which the controlling entity of the controlled entity has continuing involvement, the controlled entity does not include the controlling entity's involvement in the assessment of whether it has continuing involvement in the transferred asset in its separate or individual financial statements (i.e., when the controlled entity is the reporting entity). However, a controlling entity would include its continuing involvement (or that of another member of the economic entity) in a financial asset transferred by its controlled entity in determining whether it has continuing involvement in the transferred asset in its consolidated financial statements (i.e., when the reporting entity is the economic entity).

AG32. An entity does not have a continuing involvement in a transferred financial asset if, as part of the transfer, it neither retains any of the contractual rights or obligations inherent in the transferred financial asset nor acquires any new contractual rights or obligations relating to the transferred financial asset. An entity does not have continuing involvement in a transferred financial asset if it has neither an interest in the future performance of the transferred financial asset nor a responsibility under any circumstances to make payments in respect of the transferred financial asset in the future. The term 'payment' in this context does not include cash flows of the transferred financial asset that an entity collects and is required to remit to the transferee.

AG32A. When an entity transfers a financial asset, the entity may retain the right to service that financial asset for a fee that is included in, for example, a servicing contract. The entity assesses the servicing contract in accordance with the guidance in paragraphs 49C and AG32 to decide whether the entity has continuing involvement as a result of the servicing contract for the purposes of the disclosure requirements. For example, a servicer will have continuing involvement in the transferred financial asset for the purposes of the disclosure requirements if the servicing fee is dependent on the amount or timing of the cash flows collected from the transferred financial asset. Similarly, a servicer has continuing involvement for the purposes of the disclosure requirements if a fixed fee would not be paid in full because of non-performance of the transferred financial asset. In these examples, the servicer has an interest in the future performance of the transferred financial asset. This assessment is independent of whether the fee to be received is expected to compensate the entity adequately for performing the servicing.

AG33. Continuing involvement in a transferred financial asset may result from contractual provisions in the transfer agreement or in a separate agreement with the transferee or a third party entered into in connection with the transfer.

Transferred Financial Assets that are Not Derecognised in Their Entirety (paragraph 49D)

AG34. Paragraph 49D requires disclosures when part or all of the transferred financial assets do not qualify for derecognition. Those disclosures are required at each reporting date at which the entity continues to recognise the transferred financial assets, regardless of when the transfers occurred.

Types of Continuing Involvement (paragraphs 49E–49H)

*AG35. Paragraphs 49E–49H require qualitative and quantitative disclosures for each type of continuing involvement in derecognised financial assets. An entity shall aggregate its continuing involvement into types that are representative of the entity's exposure to risks. For example, an entity may aggregate its continuing involvement by type of financial instrument (e.g., guarantees or call options) or by type of transfer (e.g., factoring of receivables, securitisations and securities lending).

Maturity Analysis for Undiscounted Cash Outflows to Repurchase Transferred Assets (paragraph 49E(e))

*AG36. Paragraph 49E(e) requires an entity to disclose a maturity analysis of the undiscounted cash outflows to repurchase derecognised financial assets or other amounts payable to the transferee in respect of the derecognised financial assets, showing the remaining contractual maturities of the entity's continuing involvement. This analysis distinguishes cash flows that are required to be paid (e.g., forward contracts), cash flows that the entity may be required to pay (e.g., written put options) and cash flows that the entity might choose to pay (e.g., purchased call options).

*AG37. An entity shall use its judgement to determine an appropriate number of time bands in preparing the maturity analysis required by paragraph 49E(e). For example, an entity might determine that the following maturity time bands are appropriate:

(a) Not later than one month;

(b) Later than one month and not later than three months;

(c) Later than three months and not later than six months;

(d) Later than six months and not later than one year;

(e) Later than one year and not later than three years;

(f) Later than three years and not later than five years; and

(g) More than five years.

*AG38. If there is a range of possible maturities, the cash flows are included on the basis of the earliest date on which the entity can be required or is permitted to pay.

Qualitative Information (paragraph 49E(f))

AG39. The qualitative information required by paragraph 49E(f) includes a description of the derecognised financial assets and the nature and purpose of the continuing involvement retained after transferring those assets. It also includes a description of the risks to which an entity is exposed, including:

(a) A description of how the entity manages the risk inherent in its continuing involvement in the derecognised financial assets.

(b) Whether the entity is required to bear losses before other parties, and the ranking and amounts of losses borne by parties whose interests rank lower than the entity's interest in the asset (i.e., its continuing involvement in the asset).

(c) A description of any triggers associated with obligations to provide financial support or to repurchase a transferred financial asset.

Gain or Loss on Derecognition (paragraph 49G(a))

*AG40. Paragraph 49G(a) requires an entity to disclose the gain or loss on derecognition relating to financial assets in which the entity has continuing involvement. The entity shall disclose if a gain or loss on derecognition arose because the fair values of the components of the previously recognised asset (i.e., the interest in the asset derecognised and the interest retained by the entity) were different from the fair value of the previously recognised asset as a whole. In that situation, the entity shall also disclose whether the fair value measurements included significant inputs that were not based on observable market data, as described in paragraph 32.

Supplementary Information (paragraph 49H)

*AG41. The disclosures required in paragraphs 49D–49G may not be sufficient to meet the disclosure objectives in paragraph 49B. If this is the case, the entity shall disclose whatever additional information is necessary to meet the disclosure objectives. The entity shall decide, in the light of its circumstances, how much additional information it needs to provide to satisfy the information needs of users and how much emphasis it places on different aspects of the additional information. It is necessary to strike a balance between burdening financial statements with excessive detail that may not assist users of financial statements and obscuring information as a result of too much aggregation.

…

Offsetting Financial Assets and Financial Liabilities (paragraphs 17A–17F)

Scope (paragraph 17A)

*AG42. The disclosures in paragraphs 17B–17E are required for all recognised financial instruments that are set off in accordance with paragraph 47 of PBE IPSAS 28. In addition, financial instruments are within the scope of the disclosure requirements in paragraphs 17B–17E if they are subject to an enforceable master netting arrangement or similar agreement that covers similar financial instruments and transactions, irrespective of whether the financial instruments are set off in accordance with paragraph 47 of PBE IPSAS 28.

*AG43. The similar agreements referred to in paragraphs 17A and AG31 include derivative clearing agreements, global master repurchase agreements, global master securities lending agreements, and any related rights to financial collateral. The similar financial instruments and transactions referred to in paragraph AG31 include derivatives, sale and repurchase agreements, reverse sale and repurchase agreements, securities borrowing, and securities lending agreements. Examples of financial instruments that are not within the scope of paragraph 17A are loans and customer deposits at the same institution (unless they are set off in the statement of financial position), and financial instruments that are subject only to a collateral agreement.

Disclosure of Quantitative Information for Recognised Financial Assets and Recognised Financial Liabilities within the Scope of Paragraph 17A (paragraph 17C)

*AG44. Financial instruments disclosed in accordance with paragraph 17C may be subject to different measurement requirements (for example, a payable related to a repurchase agreement may be measured at amortised cost, while a derivative will be measured at fair value). An entity shall include instruments at their recognised amounts and describe any resulting measurement differences in the related disclosures.

Disclosure of the Gross Amounts of Recognised Financial Assets and Recognised Financial Liabilities within the Scope of Paragraph 17A (paragraph 17C(a))

*AG45. The amounts required by paragraph 17C(a) relate to recognised financial instruments that are set off in accordance with paragraph 47 of PBE IPSAS 28. The amounts required by paragraph 17C(a) also relate to recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreement irrespective of whether they meet the offsetting criteria. However, the disclosures required by paragraph 17C(a) do not relate to any amounts recognised as a result of collateral agreements that do not meet the offsetting criteria in paragraph 47 of PBE IPSAS 28. Instead, such amounts are required to be disclosed in accordance with paragraph 17C(d).

Disclosure of the Amounts that are Set Off in Accordance with the Criteria in Paragraph 47 of PBE IPSAS 28 (paragraph 17C(b))

*AG46. Paragraph 17C(b) requires that entities disclose the amounts set off in accordance with paragraph 47 of PBE IPSAS 28 when determining the net amounts presented in the statement of financial position. The amounts of both the recognised financial assets and the recognised financial liabilities that are subject to set-off under the same arrangement will be disclosed in both the financial asset and financial liability disclosures. However, the amounts disclosed (in, for example, a table) are limited to the amounts that are subject to set-off. For example, an entity may have a recognised derivative asset and a recognised derivative liability that meet the offsetting criteria in paragraph 47 of PBE IPSAS 28. If the gross amount of the derivative asset is larger than the gross amount of the derivative liability, the financial asset disclosure table will include the entire amount of the derivative asset (in accordance with paragraph 17C(a)) and the entire amount of the derivative liability (in accordance with paragraph 17C(b)). However, while the financial liability disclosure table will include the entire amount of the derivative liability (in accordance with paragraph 17C(a)), it will only include the amount of the derivative asset (in accordance with paragraph 137(b)) that is equal to the amount of the derivative liability.

Disclosure of the Net Amounts Presented in the Statement of Financial Position (paragraph 17C(c))

*AG47. If an entity has instruments that meet the scope of these disclosures (as specified in paragraph 17A), but that do not meet the offsetting criteria in paragraph 47 of PBE IPSAS 28, the amounts required to be disclosed by paragraph 17C(c) would equal the amounts required to be disclosed by paragraph 17C(a).

*AG48. The amounts required to be disclosed by paragraph 17C(c) must be reconciled to the individual line item amounts presented in the statement of financial position. For example, if an entity determines that the aggregation or disaggregation of individual financial statement line item amounts provides more relevant information, it must reconcile the aggregated or disaggregated amounts disclosed in paragraph 17C(c) back to the individual line item amounts presented in the statement of financial position.

Disclosure of the Amounts Subject to an Enforceable Master Netting Arrangement or Similar Agreement that are not Otherwise Included in Paragraph 17C(b) (paragraph 17C(d))

*AG49. Paragraph 17C(d) requires that entities disclose amounts that are subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in paragraph 17C(b). Paragraph 17C(d)(i) refers to amounts related to recognised financial instruments that do not meet some or all of the offsetting criteria in paragraph 47 of PBE IPSAS 28 (for example, current rights of set-off that do not meet the criterion in paragraph 47(b) of PBE IPSAS 28, or conditional rights of set-off that are enforceable and exercisable only in the event of default, or only in the event of insolvency or bankruptcy of any of the counterparties).

*AG50. Paragraph 17C(d)(ii) refers to amounts related to financial collateral, including cash collateral, both received and pledged. An entity shall disclose the fair value of those financial instruments that have been pledged or received as collateral. The amounts disclosed in accordance with paragraph 17C(d)(ii) should relate to the actual collateral received or pledged and not to any resulting payables or receivables recognised to return or receive back such collateral.

Limits on the Amounts Disclosed in Paragraph 17C(d) (paragraph 17D)

*AG51. When disclosing amounts in accordance with paragraph 17C(d), an entity must take into account the effects of over-collateralisation by financial instrument. To do so, the entity must first deduct the amounts disclosed in accordance with paragraph 17C(d)(i) from the amount disclosed in accordance with paragraph 17C(c). The entity shall then limit the amounts disclosed in accordance with paragraph 17C(d)(ii) to the remaining amount in paragraph 17C(c) for the related financial instrument. However, if rights to collateral can be enforced across financial instruments, such rights can be included in the disclosure provided in accordance with paragraph 17D.

Description of the Rights of Set-Off Subject to Enforceable Master Netting Arrangements and Similar Agreements (paragraph 17E)

*AG52. An entity shall describe the types of rights of set-off and similar arrangements disclosed in accordance with paragraph 17C(d), including the nature of those rights. For example, an entity shall describe its conditional rights. For instruments subject to rights of set-off that are not contingent on a future event but that do not meet the remaining criteria in paragraph 47 of PBE IPSAS 28, the entity shall describe the reason(s) why the criteria are not met. For any financial collateral received or pledged, the entity shall describe the terms of the collateral agreement (for example, when the collateral is restricted).

Disclosure by Type of Financial Instrument or by Counterparty

*AG53. The quantitative disclosures required by paragraph 17C(a)–(e) may be grouped by type of financial instrument or transaction (for example, derivatives, repurchase and reverse repurchase agreements or securities borrowing and securities lending agreements).

*AG54. Alternatively, an entity may group the quantitative disclosures required by paragraph 17C(a)–(c) by type of financial instrument, and the quantitative disclosures required by paragraph 17C(c)–(e) by counterparty. If an entity provides the required information by counterparty, the entity is not required to identify the counterparties by name. However, designation of counterparties (Counterparty A, Counterparty B, Counterparty C, etc.) shall remain consistent from year to year for the years presented to maintain comparability. Qualitative disclosures shall be considered so that further information can be given about the types of counterparties. When disclosure of the amounts in paragraph 17C(c)–(e) is provided by counterparty, amounts that are individually significant in terms of total counterparty amounts shall be separately disclosed and the remaining individually insignificant counterparty amounts shall be aggregated into one line item.

Other

*AG55. The specific disclosures required by paragraphs 17C–17E are minimum requirements. To meet the objective in paragraph 17B an entity may need to supplement them with additional (qualitative) disclosures, depending on the terms of the enforceable master netting arrangements and related agreements, including the nature of the rights of set-off, and their effect or potential effect on the entity's financial position.

Paragraphs IG3 and IG4 and the related heading are deleted.

The heading above paragraph IG7 which begins "*Significance of Financial Instruments*..." is footnoted. The heading immediately above paragraph IG7 and paragraphs IG7–IG11 are deleted.

Paragraph IG13 is amended.
Paragraphs IG13A to IG13C and the related heading are added.

The illustrative disclosures following paragraphs IG14 and IG15 are amended. The text of paragraphs IG14 and IG15 is shown for ease of reading.

Paragraph IG16 and the illustrative disclosure following paragraph IG16 are amended.

Paragraphs IG22A–IG22D and the related headings are added.

Paragraphs IG25–IG31 and the related headings are deleted.

Paragraphs IG41–IG44 and IG45 and the related headings are added.

New text is underlined and deleted text is struck through.

~~*Materiality*~~

IG3–IG4 [Deleted by IPSASB]

…

Significance of Financial Instruments for Financial Position and Financial Performance (paragraphs 10–36, AG4 and AG5)[1]

~~*Financial Liabilities at Fair Value through Surplus or Deficit (paragraphs 13(a)(i) and AG4)*~~

IG7–IG11 [Deleted by IPSASB]

[1] PBE IPSAS 41 *Financial Instruments* deleted paragraph AG4 of PBE IPSAS 30.

…

Total Interest Expense (paragraph 24(b))

IG13. Total interest expense disclosed in accordance with paragraph 24(b) is a component of the finance costs, which paragraph 99.1(b) ~~102(b)~~ of PBE IPSAS 1 requires to be presented separately in the statement of comprehensive revenue and expense ~~financial performance~~. The line item for finance costs may also include amounts associated with non-financial liabilities.

Hedge Accounting (paragraphs 28A–28C)

IG13A. Paragraph 28A of PBE IPSAS 30 requires that an entity discloses amounts related to items designated as hedging instruments in a tabular format. The following example illustrates how that information might be disclosed.

	Nominal amount of the hedging instrument	Carrying amount of the hedging instrument		Line item in the statement of financial position where the hedging instrument is located	Changes in fair value used for calculating hedge ineffectiveness for 20X1
		Assets	Liabilities		
Cash flow hedges					
Commodity price risk - Forward sales contracts	xx	xx	xx	Line item XX	xx
Fair value hedges					
Interest rate risk - Interest rate swaps	xx	xx	xx	Line item XX	xx
Foreign exchange risk - Foreign currency loan	xx	xx	xx	Line item XX	xx

IG13B. Paragraph 28A of PBE IPSAS 30 requires that an entity discloses amounts related to items designated as hedged items in a tabular format. The following example illustrates how that information might be disclosed.

	Carrying amount of the hedged item		Accumulated amount of fair value hedge adjustments on the hedged item included in the carrying amount of the hedged item		Line item in the statement of financial position in which the hedged item is included	Change in value used for calculating hedge ineffective-ness for 20X1	Cash flow hedge reserve
	Assets	Liabilities	Assets	Liabilities			
Cash flow hedges							
Commodity price risk - Forecast sales - Discontinued hedges (forecast sales)	n/a n/a	n/a n/a	n/a n/a	n/a n/a	n/a n/a	xx n/a	xx xx
Fair value hedges							
Interest rate risk - Loan payable - Discontinued hedges (Loan payable)	– –	xx xx	– –	xx xx	Line item XX Line item XX	xx n/a	n/a n/a
Foreign exchange risk - Firm commitment	xx	xx	xx	xx	Line item XX	xx	n/a

IG13C. Paragraph 28C of PBE IPSAS 30 requires that an entity discloses amounts that have affected the statement of comprehensive revenue and expense as a result of applying hedge accounting in a tabular format. The following example illustrates how that information might be disclosed.

Cash flow hedges[a]	Separate line item recognised in surplus or deficit as a result of a hedge of a net position[b]	Change in the value of the hedging instrument recognised in other comprehensive revenue and expense	Hedge ineffectiveness recognised in surplus or deficit	Line item in surplus or deficit (that includes hedge ineffectiveness)	Amount reclassified from the cash flow hedge reserve to surplus or deficit	Line item affected in surplus or deficit ~~because of the reclassification~~
Commodity price risk						
Commodity X	n/a	xx	xx	Line item XX	xx	Line item XX
- Discontinued hedge	n/a	n/a	n/a	n/a	xx	Line item XX

(a) The information disclosed in the statement of changes in net assets/equity (cash flow hedge reserve) should have the same level of detail as these disclosures.

(b) This disclosure only applies to cash flow hedges of foreign currency risk.

Fair value hedges	Ineffectiveness recognised in surplus or deficit	Line item(s) in surplus or deficit (that include(s) hedge ineffectiveness)
Interest rate risk	xx	Line item XX
Foreign exchange risk	xx	Line item XX

…

Fair Value (paragraphs 31–34)

IG14. PBE IPSAS 30 requires disclosures about the level in the fair value hierarchy in which fair value measurements are categorised for assets and liabilities measured in the statement of financial position. A tabular format is required unless another format is more appropriate. An entity might disclose the following for assets to comply with paragraph 33(a). (Disclosure of comparative information is also required, but is not included in the following example.)

Assets Measured at Fair Value

		Fair value measurement at end of the reporting period using:		
		Level 1	**Level 2**	**Level 3**
Description	**Dec 31, 20X2**	**CU million**	**CU million**	**CU million**
Financial assets at fair value through surplus or deficit				
Trading securities	100	40	55	5
Trading derivatives	39	17	20	2
~~Available-for-sale~~ Financial assets at fair value through other comprehensive revenue and expense				
Equity investments	75	30	40	5
Total	214	87	115	12

Note: For liabilities, a similar table might be presented.

IG15. PBE IPSAS 30 requires a reconciliation from beginning to ending balances for those assets and liabilities that are measured in the statement of financial position at fair value based on a valuation technique for which any significant input is not based on observable market data (Level 3). A tabular format is required unless another format is more appropriate. An entity might disclose the following for assets to comply with paragraph 33(b). (Disclosure of comparative information is also required, but is not included in the following example).

Assets Measured at Fair Value Based on Level 3

	Fair value measurement at the end of the reporting period			
	Financial assets at fair value through surplus or deficit		**Financial assets at fair value through other comprehensive revenue and expense** ~~**Available-for-sale financial assets**~~	**Total**
	Trading securities	Trading derivatives	Equity investments	
	CU million	CU million	CU million	CU million
Opening balance	6	5	4	15
Total gains or losses				
in surplus or deficit	(2)	(2)	-	(4)
in other comprehensive revenue and expense	-	-	(1)	(1)
Purchases	1	2	2	5
Issues	-	-	-	-
Settlements	-	(1)	-	(1)
Transfers out of Level 3	-	(2)	-	(2)
Closing balance	5	2	5	12
Total gains or losses for the period included in surplus or deficit for assets held at the end of the reporting period	(1)	(1)	-	(2)

(Note: For liabilities, a similar table might be presented.)

Gains or losses included in surplus or deficit for the period (above) are presented in revenue as follows:

	Revenue
Total gains or losses included in surplus or deficit for the period	(4)
Total gains or losses for the period included in surplus or deficit for assets held at the end of the reporting period	(2)

(Note: For liabilities, a similar table might be presented.)

….

IG16. The fair value at initial recognition of financial instruments that are not traded in active markets is determined in accordance with paragraph AG151 of PBE IPSAS 41~~AG108 of PBE IPSAS 29~~. However, when, after initial recognition, an entity will use a valuation technique that incorporates data not obtained from observable markets, there may be a difference between the transaction price at initial recognition and the amount determined at initial recognition using that valuation technique. In these circumstances, the difference will be recognised in surplus or deficit in subsequent periods in accordance with ~~PBE IPSAS 29~~ PBE IPSAS 41 and the entity's accounting policy. Such recognition reflects changes in factors (including time) that market participants would consider in setting a price (see paragraph AG151 of PBE IPSAS 41~~AG108 of PBE IPSAS 29~~). Paragraph ~~33~~34 requires disclosures in these circumstances. An entity might disclose the following to comply with paragraph 34:

Background

…

Accounting Policies

The entity uses the following valuation technique to determine the fair value of financial instruments that are not traded in an active market: [description of technique not included in this example]. Differences may arise between the fair value at initial recognition (which, in accordance with ~~PBE IPSAS 29~~PBE IPSAS 41, is generally the transaction price) and the amount determined at initial recognition using the valuation technique. Any such differences are [description of the entity's accounting policy].

In the Notes to the Financial Statements

As discussed in note X, the entity uses [name of valuation technique] to measure the fair value of the following financial instruments that are not traded in an active market. However, in accordance with ~~PBE IPSAS 29~~ PBE IPSAS 41, the fair value of an instrument at inception is generally the transaction price. If the transaction price differs from the amount determined at inception using the valuation technique, that difference is [description of the entity's accounting policy].

...

Credit Risk (paragraphs 42A–43, AG8A–AG10)

IG22A. The following examples illustrate possible ways in which an entity might provide the disclosures required by paragraphs 42A–42N of PBE IPSAS 30. However, these illustrations do not address all possible ways of applying the disclosure requirements.

Illustrating the Application of Paragraphs 42H and 42I

IG22B. The following example illustrates one way of providing information about the changes in the loss allowance and the significant changes in the gross carrying amount of financial assets during the period that contributed to changes in the loss allowance as required by paragraphs 42H–42I. This example does not illustrate the requirements for financial assets that are purchased or originated credit-impaired.

Mortgage loans–loss allowance	**12-month expected credit losses**	**Lifetime expected credit losses (collectively assessed)**	**Lifetime expected credit losses (individually assessed)**	**Credit-impaired financial assets (lifetime expected credit losses)**
CU'000				
Loss allowance as at January 1	**X**	**X**	**X**	**X**
Changes due to financial instruments recognised as at 1 January:				
- Transfer to lifetime expected credit losses	(X)	X	X	–
- Transfer to credit-impaired financial assets	(X)	–	(X)	X
- Transfer to 12-month expected credit losses	X	(X)	(X)	–
- Financial assets that have been derecognised during the period	(X)	(X)	(X)	(X)
New financial assets originated or purchased	X	–	–	–
Write-offs	–	–	(X)	(X)
Changes in models/risk parameters	X	X	X	X
Foreign exchange and other movements	X	X	X	X
Loss allowance as at December 31	**X**	**X**	**X**	**X**

Significant changes in the gross carrying amount of mortgage loans that contributed to changes in the loss allowance were:

- The acquisition of the ABC prime mortgage portfolio increased the residential mortgage book by x percent, with a corresponding increase in the loss allowance measured on a 12-month basis.
- The write off of the CUXX DEF portfolio following the collapse of the local market reduced the loss allowance for financial assets with objective evidence of impairment by CUX.
- The expected increase in unemployment in Region X caused a net increase in financial assets whose loss allowance is equal to lifetime expected credit losses and caused a net increase of CUX in the lifetime expected credit losses allowance.

The significant changes in the gross carrying amount of mortgage loans are further explained below:

Mortgage loans–gross carrying amount	**12-month expected credit losses**	**Lifetime expected credit losses (collectively assessed)**	**Lifetime expected credit losses (individually assessed)**	**Credit-impaired financial assets (lifetime expected credit losses)**
CU'000				
Gross carrying amount as at January 1	**X**	**X**	**X**	**X**
Individual financial assets transferred to lifetime expected credit losses	(X)	–	X	–
Individual financial assets transferred to credit-impaired financial assets	(X)	–	(X)	X
Individual financial assets transferred from credit-impaired financial assets	X	–	X	(X)
Financial assets assessed on collective basis	(X)	X	–	–
New financial assets originated or purchased	X	–	–	–
Write-offs	–	–	(X)	(X)
Financial assets that have been derecognised	(X)	(X)	(X)	(X)
Changes due to modifications that did not result in derecognition	(X)	–	(X)	(X)
Other changes	X	X	X	X
Gross carrying amount as at December 31	**X**	**X**	**X**	**X**

Illustrating the Application of Paragraphs 42M and 42N

IG22C. The following example illustrates some ways of providing information about an entity's credit risk exposure and significant credit risk concentrations in accordance with paragraph 42M of PBE IPSAS 30. The number of grades used to disclose the information in accordance with paragraph 42M of PBE IPSAS 30 shall be consistent with the number that the entity uses to report internally to key management personnel for internal credit risk management purposes. However, if information about credit risk rating grades is not available without undue cost or effort and an entity uses past due information to assess whether credit risk has increased significantly since initial recognition in accordance with paragraph 83 of PBE IPSAS 41, the entity shall provide an analysis by past due status for those financial assets.

Consumer loan credit risk exposure by internal rating grades				
20XX	**Consumer—credit card**		**Consumer—automotive**	
CU'000	**Gross carrying amount**		**Gross carrying amount**	
	Lifetime	**12-month**	**Lifetime**	**12-month**
Internal Grade 1–2	X	X	X	X
Internal Grade 3–4	X	X	X	X
Internal Grade 5–6	X	X	X	X
Internal Grade 7	X	X	X	X
Total	**X**	**X**	**X**	**X**

Corporate loan credit risk profile by external rating grades				
20XX	**Corporate—equipment**		**Corporate—construction**	
CU'000	**Gross carrying amount**		**Gross carrying amount**	
	Lifetime	**12-month**	**Lifetime**	**12-month**
AAA-AA	X	X	X	X
A	X	X	X	X
BBB-BB	X	X	X	X
B	X	X	X	X
CCC-CC	X	X	X	X
C	X	X	X	X
D	X	X	X	X
Total	**X**	**X**	**X**	**X**

Corporate loan risk profile by probability of default				
20XX	**Corporate—unsecured**		**Corporate—secured**	
CU'000	**Gross carrying amount**		**Gross carrying amount**	
	Lifetime	**12-month**	**Lifetime**	**12-month**
0.00 – 0.10	X	X	X	X
0.11 – 0.40	X	X	X	X
0.41 – 1.00	X	X	X	X
1.01 – 3.00	X	X	X	X
3.01 – 6.00	X	X	X	X
6.01 – 11.00	X	X	X	X
11.01 – 17.00	X	X	X	X
17.01 – 25.00	X	X	X	X
25.01 – 50.00	X	X	X	X
50.01+	X	X	X	X
Total	**X**	**X**	**X**	**X**

IG22D. Entity A manufactures cars and provides financing to both dealers and end customers. Entity A discloses its dealer financing and customer financing as separate classes of financial instruments and applies the simplified approach to its trade receivables so that the loss allowance is always measured at an amount equal to lifetime expected credit losses. The following table illustrates the use of a provision matrix as a risk profile disclosure under the simplified approach:

20XX CU'000	**Trade receivables days past due**				
Dealer financing	**Current**	**More than 30 days**	**More than 60 days**	**More than 90 days**	**Total**
Expected credit loss rate	0.10%	2%	5%	13%	
Estimated total gross carrying amount at default	CU20,777	CU1,416	CU673	CU235	CU23,101
Lifetime expected credit losses—dealer financing	CU21	CU28	CU34	CU31	CU114
Customer financing					
Expected credit loss rate	0.20%	3%	8%	15%	
Estimated total gross carrying amount at default	CU19,222	CU2,010	CU301	CU154	CU21,687
Lifetime expected credit losses— customer financing	CU38	CU60	CU24	CU23	CU145

IG25–IG31. [Deleted by IPSASB]

~~*Credit Quality (paragraph 43(c))*~~ …

~~*Financial Assets that are either Past Due or Impaired (paragraph 44)*~~ …

…

Market Risk (paragraphs 47–49 and AG19–AG30)

…

IG36. The following example illustrates the application of the disclosure requirement in paragraph 47(a):

> **Interest Rate Risk**
>
> At December 31, 20X2, if interest rates at that date had been 10 basis points lower with all other variables held constant, surplus for the year would have been CU1.7 million (20X1—CU2.4 million) higher, arising mainly as a result of lower interest expense on variable borrowings.~~, and other comprehensive revenue and expense would have been CU2.8 million (20X1—CU3.2 million) higher, arising mainly as a result of an increase in the fair value of fixed rate financial assets classified as available for sale~~. If interest rates had been 10 basis points higher, with all other variables held constant, surplus would have been CU1.5 million (20X1—CU2.1 million) lower, arising mainly as a result of higher interest expense on variable borrowings.~~, other comprehensive revenue and expense would have been CU3.0 million (20X1—CU3.4 million) lower, arising mainly as a result of a decrease in the fair value of fixed rate financial assets classified as available for sale~~. Surplus is more sensitive to interest rate decreases than increases because of borrowings with capped interest rates. The sensitivity is lower in 20X2 than in 20X1 because of a reduction in outstanding borrowings that has occurred as the entity's debt has matured (see note X). [footnote omitted]
>
> …

Derecognition (paragraphs 49D and 49E)

IG41. The following examples illustrate some possible ways to meet the quantitative disclosure requirements in paragraphs 49D and 49E.

IG42. The following examples illustrate how an entity that has adopted PBE IPSAS 41 might meet the quantitative disclosure requirements in paragraphs 49D and 49E.

Transferred Financial Assets that are not Derecognised in their Entirety

Illustrating the Application of Paragraph 49D(d) and (e)

	Financial assets at fair value through surplus or deficit		**Financial assets at amortised cost**		**Financial assets at fair value through other comprehensive revenue and expense**
	CU million		CU million		CU million
	Trading assets	Derivatives	Mortgages	Consumer loans	Equity investments
Carrying amount of assets	X	X	X	X	X
Carrying amount of associated liabilities	(X)	(X)	(X)	(X)	(X)
For those liabilities that have recourse only to the transferred assets:					
Fair value of assets	X	X	X	X	X
Fair value of associated liabilities	(X)	(X)	(X)	(X)	(X)
Net position	X	X	X	X	X

Transferred Financial Assets that are Derecognised in their Entirety

Illustrating the Application of Paragraph 49E(a)–(d)

	Cash outflows to repurchase transferred (derecognised) assets	**Carrying amount of continuing involvement in statement of financial position**			**Fair value of continuing involvement**		**Maximum exposure to loss**
	CU million	CU million			CU million		CU million
Type of continuing involvement		**Financial assets at fair value through surplus or deficit**	**Financial assets at fair value through other comprehend-sive revenue and expense**	**Financial liabilities at fair value through surplus or deficit**	**Assets**	**Liabilities**	
Written put options	(X)			(X)		(X)	X
Purchased call options	(X)	X			X		X
Securities lending	(X)			(X)	X	(X)	X
Total		X		(X)	X	(X)	X

Illustrating the Application of Paragraph 49E(e)

Undiscounted cash flows to repurchase transferred assets								
	Maturity of continuing involvement CU million							
Type of continuing involvement	Total	less than 1 month	1–3 months	3–6 months	6 months –1 year	1–3 years	3–5 years	more than 5 years
Written put options	X		X	X	X	X		
Purchased call options	X			X	X	X		X
Securities lending	X	X	X					

IG43. The following examples illustrate how an entity that has not adopted PBE IPSAS 41 might meet the quantitative disclosure requirements in paragraphs 49D and 49E.

Transferred Financial Assets that are not Derecognised in their Entirety

Illustrating the Application of Paragraph 49D(d) and (e)

	Financial assets at fair value through surplus or deficit		**Loans and receivables**		**Available-for-sale financial assets**
	CU million		CU million		CU million
	Trading securities	Derivatives	Mortgages	Consumer loans	Equity investments
Carrying amount of assets	X	X	X	X	X
Carrying amount of associated liabilities	(X)	(X)	(X)	(X)	(X)
For those liabilities that have recourse only to the transferred assets:					
Fair value of assets	X	X	X	X	X
Fair value of associated liabilities	(X)	(X)	(X)	(X)	(X)
Net position	X	X	X	X	X

Transferred Financial Assets that are Derecognised in their Entirety

Illustrating the Application of Paragraph 49E(a)–(d)

	Cash outflows to repurchase transferred (derecognised) assets	**Carrying amount of continuing involvement in statement of financial position**			**Fair value of continuing involvement**		**Maximum exposure to loss**
	CU million	**CU million**			**CU million**		**CU million**
Type of continuing involvement		**Held for trading**	**Available-for-sale financial assets**	**Financial liabilities at fair value through surplus or deficit**	**Assets**	**Liabilities**	
Written put options	(X)			(X)		(X)	X
Purchased call options	(X)	X			X		X
Securities lending	(X)		X	(X)	X	(X)	X
Total		X	X	(X)	X	(X)	X

Illustrating the Application of Paragraph 49E(e)

Undiscounted cash flows to repurchase transferred assets								
Maturity of continuing involvement CU million								
Type of continuing involvement	Total	less than 1 month	1–3 months	3–6 months	6 months – 1 year	1–3 years	3–5 years	more than 5 years
Written put options	X		X	X	X	X		
Purchased call options	X			X	X	X		X
Securities lending	X	X	X					

Disclosures (paragraphs 17A–17F and AG42-55)

IG44. The following examples illustrate ways in which an entity might provide the quantitative disclosures required by paragraph 17C. However, these illustrations do not address all possible ways of applying the disclosure requirements as set out in paragraphs 17B–17E.

Background

An entity has entered into transactions subject to an enforceable master netting arrangement or similar agreement with the following counterparties. The entity has the following recognised financial assets and financial liabilities resulting from those transactions that meet the scope of the disclosure requirements in paragraph 17A.

Counterparty A:

The entity has a derivative asset (fair value of CU100 million) and a derivative liability (fair value of CU80 million) with Counterparty A that meet the offsetting criteria in paragraph 47 of PBE IPSAS 28. Consequently, the gross derivative liability is set off against the gross derivative asset, resulting in the presentation of a net derivative asset of CU20 million in the entity's statement of financial position. Cash collateral has also been received from Counterparty A for a portion of the net derivative asset (CU10 million). The cash collateral of CU10 million does not meet the offsetting criteria in paragraph 47 of PBE IPSAS 28, but it can be set off against the net amount of the derivative asset and derivative liability in the case of default and insolvency or bankruptcy, in accordance with an associated collateral arrangement.

Counterparty B:

The entity has a derivative asset (fair value of CU100 million) and a derivative liability (fair value of CU80 million) with Counterparty B that do not meet the offsetting criteria in paragraph 47 of PBE IPSAS 28, but which the entity has the right to set off in the case of default and insolvency or bankruptcy. Consequently, the gross amount of the derivative asset (CU100 million) and the gross amount of the derivative liability (CU80 million) are presented separately in the entity's statement of financial position. Cash collateral has also been received from Counterparty B for the net amount of the derivative asset and derivative liability (CU20 million). The cash collateral of CU20 million does not meet the offsetting criteria in paragraph 47 of PBE IPSAS 28, but it can be set off against the net amount of the derivative asset and derivative liability in the case of default and insolvency or bankruptcy, in accordance with an associated collateral arrangement.

Counterparty C:

The entity has entered into a sale and repurchase agreement with Counterparty C that is accounted for as a collateralised borrowing. The carrying amount of the financial assets (bonds) used as collateral and posted by the entity for the transaction is CU79 million and their fair value is CU85 million. The carrying amount of the collateralised borrowing (repo payable) is CU80 million.

The entity has also entered into a reverse sale and repurchase agreement with Counterparty C that is accounted for as a collateralised lending. The fair value of the financial assets (bonds) received as collateral (and not recognised in the entity's statement of financial position) is CU105 million. The carrying amount of the collateralised lending (reverse repo receivable) is CU90 million.

The transactions are subject to a global master repurchase agreement with a right of set-off only in default and insolvency or bankruptcy and therefore do not meet the offsetting criteria in paragraph 47 of PBE IPSAS 28. Consequently, the related repo payable and repo receivable are presented separately in the entity's statement of financial position.

Illustrating the Application of Paragraph 17C(a)–(e) by Type of Financial Instrument

Financial Assets Subject to Offsetting, Enforceable Master Netting Arrangements and Similar Agreements

CU million

As at December 31, 20XX	(a)	(b)	(c)=(a)-(b)	(d)		(e)=(c)-(d)
				Related amounts not set off in the statement of financial position		
	Gross amounts of recognised financial assets	Gross amounts of recognised financial liabilities set off in the statement of financial position	Net amounts of financial assets presented in the statement of financial position	(d)(i), (d)(ii) Financial instruments	(d)(ii) Cash collateral received	Net amount
Description						
Derivatives	200	(80)	120	(80)	(30)	10
Reverse repurchase, securities borrowing and similar agreements	90	–	90	(90)	–	–
Other financial instruments	–	–	–	–	–	–
Total	290	(80)	210	(170)	(30)	10

Financial Liabilities Subject to Offsetting, Enforceable Master Netting Arrangements and Similar Agreements

CU million						
As at December 31, 20XX	**(a)**	**(b)**	**(c)=(a)-(b)**	**(d)**		**(e)=(c)-(d)**
				Related amounts not set off in the statement of financial position		
	Gross amounts of recognised financial liabilities	**Gross amounts of recognised financial assets set off in the statement of financial position**	**Net amounts of financial liabilities presented in the statement of financial position**	**(d)(i), (d)(ii) Financial instruments**	**(d)(ii) Cash collateral pledged**	**Net amount**
Description						
Derivatives	160	(80)	80	(80)	–	–
Repurchase, securities lending and similar agreements	80	–	80	(80)	–	–
Other financial instruments	–	–	–	–	–	–
Total	240	(80)	160	(160)	–	–

Illustrating the Application of Paragraph 17C(a)–(c) by Type of Financial Instrument and Paragraph 17C(c)–(e) by Counterparty

Financial Assets Subject to Offsetting, Enforceable Master Netting Arrangements and Similar Agreements

CU million			
As at December 31, 20XX	**(a)**	**(b)**	**(c)=(a)-(b)**
	Gross amounts of recognised financial assets	**Gross amounts of recognised financial liabilities set off in the statement of financial position**	**Net amounts of financial assets presented in the statement of financial position**
Description			
Derivatives	200	(80)	120
Reverse repurchase, securities borrowing and similar agreements	90	–	90
Other financial instruments	–	–	–
Total	290	(80)	210

Net Financial Assets Subject to Enforceable Master Netting Arrangements and Similar Agreements, by Counterparty

CU million				
As at December 31, 20XX	**(c)**	**(d)**		**(e)=(c)-(d)**
		Related amounts not set off in the statement of financial position		
	Net amounts of financial assets presented in the statement of financial position	**(d)(i), (d)(ii) Financial instruments**	**(d)(ii) Cash collateral received**	**Net amount**
Counterparty A	20	–	(10)	10
Counterparty B	100	(80)	(20)	–
Counterparty C	90	(90)	–	–
Other	–	–	–	–
Total	210	(170)	(30)	10

Financial Liabilities Subject to Offsetting, Enforceable Master Netting Arrangements and Similar Agreements

CU million			
As at December 31, 20XX	**(a)**	**(b)**	**(c)=(a)-(b)**
	Gross amounts of recognized financial liabilities	**Gross amounts of recognized financial assets set off in the statement of financial position**	**Net amounts of financial liabilities presented in the statement of financial position**
Description			
Derivatives	160	(80)	80
Repurchase, securities lending and similar agreements	80	–	80
Other financial instruments	–	–	–
Total	240	(80)	160

Net Financial Liabilities Subject to Enforceable Master Netting Arrangements and Similar Agreements, by Counterparty

CU million				
As at December 31, 20XX	**(c)**	**(d)**		**(e)=(c)-(d)**
		Related amounts not set off in the statement of financial position		
	Net amounts of financial liabilities presented in the statement of financial position	**(d)(i), (d)(ii) Financial instruments**	**(d)(ii) Cash collateral pledged**	**Net amount**
Counterparty A	–	–	–	–
Counterparty B	80	(80)	–	–
Counterparty C	80	(80)	–	–
Other	–	–	–	–
Total	160	(160)	–	–

Transition from PBE IPSAS 29 to PBE IPSAS 41 (paragraphs 49K–49O)

IG45. The following illustration is an example of one possible way to meet the quantitative disclosure requirements in paragraphs 49K–49O of PBE IPSAS 30 at the date of initial application of PBE IPSAS 41. However, this illustration does not address all possible ways of applying the disclosure requirements of this PBE Standard.

Reconciliation of statement of financial position balances from PBE IPSAS 29 to PBE IPSAS 41 at January 1, 2022

Financial assets	**(i)**	**(ii)**	**(iii)**	**(iv) = (i) + (ii) + (iii)**	**(v) = (iii)**
	PBE IPSAS 29 carrying amount December 31, 2021[1]	**Reclassifications**	**Remeasurements**	**PBE IPSAS 41 carrying amount January 1, 2022**	**Accumulated comprehensive revenue and expense effect on January 1, 2022** [2], [3]
Fair value through surplus or deficit					
Additions:					
From available for sale (PBE IPSAS 29)		(a)			(c)
From amortised cost (PBE IPSAS 29) – required reclassification		(b)			
From amortised cost (PBE IPSAS 29) – fair value option elected at January 1, 2022					
Subtractions:					
To amortised cost (PBE IPSAS 41)					
To fair value through other comprehensive revenue and expense – debt instruments (PBE IPSAS 41)					
To fair value through other comprehensive revenue and expense – equity instruments (PBE IPSAS 41)					
Total change to fair value through surplus or deficit					
Fair value through other comprehensive revenue and expense					
Additions – debt instruments:					
From available for sale (PBE IPSAS 29)					(g)
From amortised cost (PBE IPSAS 29)					(h)
From fair value through surplus or deficit (PBE IPSAS 29) – required reclassification based on classification criteria					(i)
From fair value through surplus or deficit (fair value option under PBE IPSAS 29) – fair value option criteria not met at January 1, 2022					(j)
From fair value through surplus or deficit (PBE IPSAS 29) – fair value option revoked at January 1, 2022 by choice					(k)
Additions – equity instruments:					
From available-for-sale (PBE IPSAS 29)					

Reconciliation of statement of financial position balances from PBE IPSAS 29 to PBE IPSAS 41 at January 1, 2022

Financial assets	**(i)**	**(ii)**	**(iii)**	**(iv) = (i) + (ii) + (iii)**	**(v) = (iii)**
	PBE IPSAS 29 carrying amount December 31, 2021[(1)]	**Reclassifications**	**Remeasurements**	**PBE IPSAS 41 carrying amount January 1, 2022**	**Accumulated comprehensive revenue and expense effect on January 1, 2022** [(2), (3)]
From fair value through surplus or deficit (fair value option under PBE IPSAS 29)–fair value through other comprehensive revenue and expense elected at January 1, 2022					
From cost (PBE IPSAS 29)					
Subtractions – debt and equity instruments:					
Available for sale (PBE IPSAS 29) to fair value through surplus or deficit (PBE IPSAS 41) – required reclassification based on classification criteria					(d)
Available for sale (PBE IPSAS 29) to fair value through surplus or deficit (PBE IPSAS 41) – fair value option elected at January 1, 2022					
Available for sale (PBE IPSAS 29) to amortised cost (PBE IPSAS 41)					(e)
Total change to fair value through other comprehensive revenue and expense					
Amortised cost					
Additions:					
From available for sale (PBE IPSAS 29)					(f)
From fair value through surplus or deficit (PBE IPSAS 29) – required reclassification					
From fair value through surplus or deficit (fair value option under PBE IPSAS 29) – fair value option criteria not met at January 1, 2022					
From fair value through surplus or deficit (PBE IPSAS 29) – fair value option revoked at January 1, 2022 by choice					
Subtractions:					
To fair value through other comprehensive revenue and expense (PBE IPSAS 41)					(l)
To fair value through surplus or deficit (PBE IPSAS 41) – required reclassification based on classification criteria					

Reconciliation of statement of financial position balances from PBE IPSAS 29 to PBE IPSAS 41 at January 1, 2022

Financial assets	**(i)**	**(ii)**	**(iii)**	**(iv) = (i) + (ii) + (iii)**	**(v) = (iii)**
	PBE IPSAS 29 carrying amount December 31, 2021(1)	**Reclassifications**	**Remeasurements**	**PBE IPSAS 41 carrying amount January 1, 2022**	**Accumulated comprehensive revenue and expense effect on January 1, 2022 (2), (3)**
To fair value through surplus or deficit (PBE IPSAS 41)–fair value option elected at January 1, 2022					
Total change to amortised cost					
Total financial asset balances, reclassifications and remeasurements at January 1, 2022	**(i)**	**Total (ii) = 0**	**(iii)**	**(iv) = (i) + (ii) + (iii)**	

1 Includes the effect of reclassifying hybrid instruments that were bifurcated under PBE IPSAS 29with host contract components of (a), which had associated embedded derivatives with a fair value of X at December 31, 2021, and (b), which had associated embedded derivatives with a fair value of Y at December 31, 2021.

2 Includes (c), (d), (e) and (f), which are amounts reclassified from other comprehensive revenue and expense to accumulated comprehensive revenue and expense at the date of initial application.

3 Includes (g), (h), (i), (j), (k) and (l), which are amounts reclassified from accumulated comprehensive revenue and expense to accumulated other comprehensive revenue and expense at the date of initial application.

PBE IPSAS 31 *Intangible Assets*

Paragraph 115 is amended. Paragraph 133.9 is added. New text is underlined and deleted text is struck through.

115. The consideration receivable on disposal of an intangible asset is recognised initially at its fair value. If payment for the intangible asset is deferred, the consideration received is recognised initially at the cash price equivalent. The difference between the nominal amount of the consideration and the cash price equivalent is recognised as interest revenue in accordance with ~~PBE IPSAS 9~~PBE IPSAS 41 reflecting the effective interest rate ~~yield~~ on the receivable.

…

133.9 **PBE IPSAS 41 *Financial Instruments*, issued in March 2019, amended paragraph 115. An entity shall apply that amendment when it applies PBE IPSAS 41.**

PBE IPSAS 32 *Service Concession Arrangements: Grantor*

Paragraphs 20, 29 and 37.4 are amended. Paragraph 37.5 is added. New text is underlined and deleted text is struck through.

20. PBE IPSAS 28 *Financial Instruments: Presentation*, ~~the derecognition requirements in PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*, and~~ PBE IPSAS 30 *Financial Instruments: Disclosures* and the derecognition requirements in PBE IPSAS 41 *Financial Instruments* apply to the financial liability recognised under paragraph 14, except where this Standard provides requirements and guidance.

…

29. **The grantor shall account for other liabilities, commitments, contingent liabilities, and contingent assets arising from a service concession arrangement in accordance with PBE IPSAS 19 *Provisions,***

***Contingent Liabilities and Contingent Assets*, PBE IPSAS 28, ~~PBE IPSAS 29 and~~ PBE IPSAS 30 and PBE IPSAS 41.**

…

37.4 **PBE IFRS 9 *Financial Instruments*, issued in January 2017, amended paragraphs 20, 29, AG37, AG45, AG52 and AG53. An entity shall apply those amendments when it applies PBE IFRS 9.***

* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.

37.5 **PBE IPSAS 41, issued in March 2019, amended paragraphs 20, 29, 37.4, AG37, AG45, AG52 and AG53. An entity shall apply those amendments when it applies PBE IPSAS 41.**

Paragraphs AG37, AG45, AG52 and AG53 are amended. New text is underlined and deleted text is struck through.

AG37. When the grantor has an unconditional obligation to make a predetermined series of payments to the operator, the liability is a financial liability as defined in PBE IPSAS 28 *Financial Instruments: Presentation* ~~PBE IPSAS 29~~. The grantor has an unconditional obligation if it has little, if any, discretion to avoid the obligation usually because of the binding arrangement with the operator being enforceable by law.

…

AG45. The finance charge related to the liability in a service concession arrangement is presented consistently with other finance charges in accordance with PBE IPSAS 28, ~~PBE IPSAS 29 and~~ PBE IPSAS 30 and PBE IPSAS 41 *Financial Instruments*.

…

AG52. Certain guarantees made by a grantor may meet the definition of a financial guarantee contract. The grantor determines whether guarantees made by the grantor as part of a service concession arrangement meet the definition of a financial guarantee contract and applies PBE IPSAS 28, ~~PBE IPSAS 29 and~~ PBE IPSAS 30 and PBE IPSAS 41 in accounting for the guarantee. Where the guarantee is an insurance contract, the grantor can elect to apply PBE IFRS 4 *Insurance Contracts*. See PBE IPSAS 28, paragraphs AG3–AG9, for further guidance.

AG53. Guarantees and commitments that do not meet the requirements in PBE IPSAS 28 and PBE IPSAS 41 ~~PBE IPSAS 29~~ relating to financial guarantee contracts or are not insurance contracts are accounted for in accordance with PBE IPSAS 19.

Paragraph BC4 is deleted. New text is underlined and deleted text is struck through.

~~Basis for Conclusions on IPSAS 32~~

BC4. [Not used]~~The NZASB decided that the IPSASB's Basis for Conclusions on IPSAS 32 should be included in PBE IPSAS 32 as it contained information that would be useful for entities applying PBE IPSAS 32.~~

In the non-integral implementation guidance that accompanies PBE IPSAS 32, the final text box in the diagram following paragraph IG2 is amended. New text is underlined and deleted text is struck through.

WITHIN THE SCOPE OF THE STANDARD

- **Grantor recognises a service concession asset, or the grantor reclassifies an item of property, plant and equipment, an intangible asset, or a leased asset as a service concession asset**
- **Grantor accounts for the service concession asset as property, plant, and equipment or an intangible asset in accordance with PBE IPSAS 17 or PBE IPSAS 31, as appropriate**
- **Grantor follows impairment testing as set out in PBE IPSAS 21 and PBE IPSAS 26**
- **Grantor recognises related liability equal to the value of the SCA asset (PBE IPSAS 9, PBE IPSAS 28, ~~PBE IPSAS 29, and~~ PBE IPSAS 30 and PBE IPSAS 41)**
- **Grantor recognises revenues and expenses related to the SCA**

PBE IPSAS 34 *Separate Financial Statements*

Paragraphs 6, 12–15, 26, 30 and 32.2 are amended. Paragraph 32.4 is added. New text is underlined and deleted text is struck through.

6. **The following terms are used in this Standard with the meanings specified:**

…

<u>**Separate financial statements**</u> **are those presented by an entity, in which the entity could elect, subject to the requirements in this Standard, to account for its investments in controlled entities, joint ventures and associates either at cost, in accordance with <u>PBE IPSAS 41 *Financial Instruments*</u> ~~PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*~~ or using the equity method as described in PBE IPSAS 36 *Investments in Associates and Joint Ventures*.**

…

12. **When an entity prepares separate financial statements, it shall account for similar investments in controlled entities, joint ventures and associates either:**

(a) **At cost;**

(b) **In accordance with <u>PBE IPSAS 41</u> ~~PBE IPSAS 29~~; or**

(c) **Using the equity method as described in PBE IPSAS 36.**

…

13. **If an entity elects, in accordance with paragraph 24 of PBE IPSAS 36, to measure its investments in associates or joint ventures at fair value through surplus or deficit in accordance with <u>PBE IPSAS 41</u> ~~PBE IPSAS 29~~, it shall also account for those investments in the same way in its separate financial statements.**

14. **If a controlling entity is required to measure its investment in a controlled entity at fair value through surplus or deficit in accordance with <u>PBE IPSAS 41</u> ~~PBE IPSAS 29~~, it shall also account for that investment in the same way in its separate financial statements. A controlling entity that is not itself an investment entity shall measure its investments in a controlled investment entity in accordance with paragraph 12 in its separate financial statements.**

15. **When a controlling entity ceases to be an investment entity, or becomes an investment entity, it shall account for the change from the date when the change in status occurred, as follows:**

(a) …

(b) **When an entity becomes an investment entity, it shall account for an investment in a controlled entity at fair value through surplus or deficit in accordance with <u>PBE IPSAS 41</u> ~~PBE IPSAS 29~~.** …

…

26. **At the date of initial application, an investment entity shall not make adjustments to the previous accounting for an interest in a controlled entity that it had previously elected to measure at fair value through surplus or deficit in accordance with <u>PBE IPSAS 41</u> ~~PBE IPSAS 29~~, as permitted in paragraph 12.**

...

30. **At the date of initial application, a controlling entity that is not itself an investment entity but which is required, in accordance with paragraph 58 of PBE IPSAS 35, to measure its investment in a controlled investment entity at fair value through surplus or deficit in accordance with <u>PBE IPSAS 41</u> ~~PBE IPSAS 29~~, shall use the transitional provisions in paragraphs 24–29 in accounting for its investment in the controlled investment entity in its separate financial statements.**

…

32.2 **PBE IFRS 9 <u>*Financial Instruments*</u>, issued in January 2017, amended paragraphs 12, 13, 14, 15, 22, 26 and 30. An entity shall apply those amendments when it applies PBE IFRS 9.<u>*</u>**

<u>* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.</u>

…

32.4 **PBE IPSAS 41, issued in March 2019, amended paragraphs 12–15, 26, 30 and 34.2. An entity shall apply those amendments when it applies PBE IPSAS 41.**

PBE IPSAS 35 *Consolidated Financial Statements*

Paragraphs 22, 45, 52, 56, 58 and 79.2 are amended. Paragraph 79.5 is added. New text is underlined and deleted text is struck through.

22. Two or more entities …collectively control another entity when they must act together to direct the relevant activities. In such cases, because no single entity can direct the activities without the co-operation of the others, no single entity controls the other entity. Each entity would account for its interest in the other entity in accordance with the relevant PBE Standards, such as PBE IPSAS 36, PBE IPSAS 37 or the PBE Standards dealing with financial instruments (PBE IPSAS 28 *Financial Instruments: Presentation*, ~~PBE IPSAS 29 *Financial Instruments: Recognition and Measurement* and~~ PBE IPSAS 30 *Financial Instruments: Disclosures* and PBE IPSAS 41 *Financial Instruments*).

…

45. PBE IPSAS 28 and ~~PBE IPSAS 29~~ PBE IPSAS 41 do not apply to interests in controlled entities that are consolidated. When instruments containing potential voting rights in substance currently give access to the benefits associated with an ownership interest in a controlled entity, the instruments are not subject to the requirements of PBE IPSAS 28 and ~~PBE IPSAS 29~~ PBE IPSAS 41. In all other cases, instruments containing potential voting rights in a controlled entity are accounted for in accordance with PBE IPSAS 28 and ~~PBE IPSAS 29~~ PBE IPSAS 41.

…

52. **If a controlling entity loses control of a controlled entity, the controlling entity:**

(a) …

(b) **Recognises any investment retained in the former controlled entity at its fair value when control is lost and subsequently accounts for it and for any amounts owed by or to the former controlled entity in accordance with relevant PBE Standards. That fair value shall be regarded as the fair value on initial recognition of a financial asset in accordance with ~~PBE IPSAS 29~~ PBE IPSAS 41 or the cost on initial recognition of an investment in an associate or joint venture; and**

(c) …

56. Except as described in paragraph 57, an investment entity shall not consolidate its controlled entities or apply PBE IFRS 3 when it obtains control of another entity. Instead, an investment entity shall measure an investment in a controlled entity at fair value through surplus or deficit in accordance with ~~PBE IPSAS 29~~ PBE IPSAS 41.

…

58. **A controlling entity of an investment entity that is not itself an investment entity shall present consolidated financial statements in which it (i) measures the investments of a controlled investment entity at fair value through surplus or deficit in accordance with ~~PBE IPSAS 29~~ PBE IPSAS 41 and (ii) consolidates the other assets and liabilities and revenue and expenses of the controlled investment entity in accordance with paragraphs 38–55 of this Standard.**

…

79.2 **PBE IFRS 9 *Financial Instruments*, issued in January 2017, amended paragraphs 22, 45, 52(b), 56, 58 and AG105, B12(b)(ii). An entity shall apply those amendments when it applies PBE IFRS 9.***

* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.

…

79.5 **PBE IPSAS 41, issued in March 2019, amended paragraphs 22, 45, 52, 56, 58, 81.2, AG105 and B12. An entity shall apply those amendments when it applies PBE IPSAS 41.**

Paragraph AG105 is amended. New text is underlined and deleted text is struck through.

AG105. In order to meet the requirement in AG104(a), an investment entity would:

(a) Elect to account for any investment property using the fair value model in PBE IPSAS 16 *Investment Property*;

(b) Elect the exemption from applying the equity method in PBE IPSAS 36 for its investments in associates and joint ventures; and

(c) Measure its financial assets at fair value using the requirements in ~~PBE IPSAS 29~~ PBE IPSAS 41 *Financial Instruments*.

Paragraph B12 is amended. New text is underlined and deleted text is struck through.

B12. Assuming that the impact of applying different accounting policies is material, consolidation adjustments are required in the following circumstances:

(a) …

(b) PBE Standards and NZ IFRS differ. Differences in the application of accounting policies can arise in the following circumstances:

(i) …

(ii) Either PBE Standards or NZ IFRS are silent or contain less guidance on a particular topic, for example, there is less guidance in NZ IFRS regarding concessionary loans. Therefore, a for-profit entity within the PBE group may have applied an accounting policy that differs from the requirements in PBE IPSAS 41 *Financial Instruments* ~~PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*~~; or

(iii) …

PBE IPSAS 36 *Investments in Associates and Joint Ventures*

Paragraphs 20, 24, 25, 25.1, 26, 43, 45 and 50.1 are amended. Paragraphs 20A, 44A–44C, 51.5 and 51.6 are added. Paragraph 44 is deleted. New text is underlined and deleted text is struck through.

20. PBE IPSAS 41 *Financial Instruments* ~~PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*~~ does not apply to interests in associates and joint ventures that are accounted for using the equity method. When instruments containing potential voting rights in substance currently give access to the benefits associated with an ownership interest in an associate or a joint venture, the instruments are not subject to ~~PBE IPSAS 29~~ PBE IPSAS 41. In all other cases, instruments containing potential voting rights in an associate or a joint venture are accounted for in accordance with ~~PBE IPSAS 29~~ PBE IPSAS 41.

20A. An entity also applies PBE IPSAS 41 to other financial instruments in an associate or joint venture to which the equity method is not applied. These include long-term interests that, in substance, form part of the entity's net investment in an associate or joint venture (see paragraph 41). An entity applies PBE IPSAS 41 to such long-term interests before it applies paragraph 41 and paragraphs 43–48 of this Standard. In applying PBE IPSAS 41, the entity does not take account of any adjustments to the carrying amount of long-term interests that arise from applying this Standard.

…

24. When an investment in an associate or joint venture is held by, or is held indirectly through, an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure that investment at fair value through surplus or deficit in accordance with ~~PBE IPSAS 29~~ PBE IPSAS 41. An entity shall make this election separately for each associate or joint venture, at initial recognition of the associate or joint venture. An investment entity will, by definition, have made this election for its investments.

25. When an entity has an investment in an associate, a portion of which is held indirectly through a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure that portion of the investment in the associate at fair value through

surplus or deficit in accordance with ~~PBE IPSAS 29~~ PBE IPSAS 41 regardless of whether the venture capital organisation, or the mutual fund, unit trust and similar entities including investment-linked insurance funds, has significant influence over that portion of the investment. If the entity makes that election, the entity shall apply the equity method to any remaining portion of its investment in an associate that is not held through a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds. When an entity has an investment in an associate, a portion of which is held indirectly through an investment entity, the entity shall measure that portion of the investment at fair value through surplus or deficit in accordance with ~~PBE IPSAS 29~~ PBE IPSAS 41.

Classification as Held for Sale

25.1 An entity shall apply PBE IFRS 5 to an investment, or a portion of an investment, in an associate or a joint venture that meets the criteria to be classified as held for sale. Any retained portion of an investment in an associate or a joint venture that has not been classified as held for sale shall be accounted for using the equity method until disposal of the portion that is classified as held for sale takes place. After the disposal takes place, an entity shall account for any retained interest in the associate or joint venture in accordance with ~~PBE IPSAS 29~~ PBE IPSAS 41 unless the retained interest continues to be an associate or a joint venture, in which case the entity uses the equity method.

Discontinuing the Use of the Equity Method

26. **An entity shall discontinue the use of the equity method from the date when its investment ceases to be an associate or a joint venture as follows:**

(a) …

(b) **If the retained interest in the former associate or joint venture is a financial asset, the entity shall measure the retained interest at fair value. The fair value of the retained interest shall be regarded as its fair value on initial recognition as a financial asset in accordance with ~~PBE IPSAS 29~~ PBE IPSAS 41. ~~If an entity is precluded by PBE IPSAS 29, paragraphs AG113 and AG114 from measuring the retained interest at fair value, the entity shall measure the retained interest at the carrying amount of the investment at the date that it ceases to be an associate or joint venture and that carrying amount shall be regarded as its cost on initial recognition as a financial asset in accordance with PBE IPSAS 29.~~ The entity shall recognise in surplus or deficit any difference between:**

(i) **The fair value ~~(or, where relevant, the carrying amount)~~ of any retained interest and any proceeds from disposing of a part interest in the associate or joint venture; and**

(ii) **The carrying amount of the investment at the date the equity method was discontinued.**

(c) **When an entity discontinues the use of the equity method, the entity shall account for all amounts previously recognised in other comprehensive revenue and expense in relation to that investment on the same basis as would have been required if the investee had directly disposed of the related assets or liabilities.**

…

43. After application of the equity method, including recognising the associate's or joint venture's deficits in accordance with paragraph 41, the entity applies ~~PBE IPSAS 29 to determine whether it is necessary to recognise any additional impairment loss with respect to its net investment in the associate or joint venture~~ paragraphs 44A–44C to determine whether there is any objective evidence that its net investment in the associate or joint venture is impaired.

44. [Deleted by IPSASB]

~~44. The entity also applies PBE IPSAS 29 to determine whether any additional impairment loss is recognised with respect to its interests in the associate or joint venture that does not constitute part of the net investment and the amount of that impairment loss.~~

44A. The net investment in an associate or joint venture is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the net investment (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows from the net investment that can be reliably estimated. It may not be possible to identify a single, discrete event that caused the impairment. Rather the combined effect of several events may have caused the impairment. Losses expected as a result of future events, no matter how likely, are not recognised. Objective evidence that the net investment is impaired includes observable data that comes to the attention of the entity about the following loss events:

(a) Significant financial difficulty of the associate or joint venture;

(b) A breach of contract, such as a default or delinquency in payments by the associate or joint venture;

(c) The entity, for economic or legal reasons relating to its associate's or joint venture's financial difficulty, granting to the associate or joint venture a concession that the entity would not otherwise consider;

(d) It becoming probable that the associate or joint venture will enter bankruptcy or other financial reorganisation; or

(e) The disappearance of an active market for the net investment because of financial difficulties of the associate or joint venture.

44B. The disappearance of an active market because the associate's or joint venture's equity or financial instruments are no longer publicly traded is not evidence of impairment. A downgrade of an associate's or joint venture's credit rating or a decline in the fair value of the associate or joint venture, is not of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information.

44C. In addition to the types of events in paragraph 44A, objective evidence of impairment for the net investment in the equity instruments of the associate or joint venture includes information about significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the associate or joint venture operates, and indicates that the cost of the investment in the equity instrument may not be recovered. A significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is also objective evidence of impairment.

45. Whenever application of paragraphs 44A–44C ~~PBE IPSAS 29~~ indicates that the investment in an associate or a joint venture may be impaired, an entity applies PBE IPSAS 26 *Impairment of Cash-Generating Assets* and possibly PBE IPSAS 21 *Impairment of Non-Cash-Generating Assets.*

…

51.2 **PBE IFRS 9 *Financial Instruments*, issued in January 2017, amended paragraphs 20, 25, 25.1 and 26, 43, 44 and 45 and added paragraphs 44A–44C. An entity shall apply those amendments when it applies PBE IFRS 9.[*]**

* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.

…

51.5 **PBE IPSAS 41, issued in March 2019, amended paragraphs 20, 24, 25, 25.1, 26, 43, 45 and 51.2, added paragraphs 20A and 44A–44C and deleted paragraph 44. An entity shall apply those amendments when it applies PBE IPSAS 41, except as specified in paragraph 51.6.**

51.6 An entity transitioning to PBE IPSAS 41 from PBE IFRS 9 shall apply the transition requirements in paragraphs 158–184 of PBE IPSAS 41 to the long-term interests described in paragraph 20A. The entity is not required to restate prior periods to reflect the application of the requirements in paragraph 20A. The entity may restate prior periods only if it is possible without the use of hindsight. If an entity does not restate prior periods, at the date of initial application of PBE IPSAS 41 it shall recognise in the opening accumulated comprehensive revenue and expense (or other component of net assets/equity, as appropriate) any difference between:

(a) the previous carrying amount of long-term interests described in paragraph 20A at that date; and

(b) the carrying amount of those long-term interests at that date.

Paragraph BC6 is added. New text is underlined and deleted text is struck through.

Long-term Interests in Associates and Joint Ventures

BC6. In October 2017 the IASB issued *Long-term Interests in Associates and Joint Ventures* (Amendments to IAS 28) to clarify that an entity is required to apply IFRS 9 *Financial Instruments*, including its impairment requirements, to long-term interests in an associate or joint venture to which the equity method is not applied but that, in substance, form part of the net investment in the associate or joint venture (long-term interests). Following the issue of IPSAS 41 *Financial Instruments* in August 2018 the IPSASB issued an amending standard (*Long-term Interests in Associates and Joint Ventures* (Amendments to IPSAS 36) *and Prepayment Features with Negative Compensation* (Amendments to IPSAS 41) to incorporate equivalent amendments in IPSAS 36 *Investments in Associates and Joint Ventures*. The NZASB amended PBE IPSAS 36 when it issued PBE IPSAS 41 *Financial Instruments*.

A non-integral illustrative example is added. New text is underlined.

Illustrative Example—Long-term Interests in Associates and Joint Ventures

This example accompanies, but is not part of, PBE IPSAS 36.

This example portrays a hypothetical situation illustrating how an entity (investor) accounts for long-term interests that, in substance, form part of the entity's net investment in an associate (long-term interests) applying PBE IPSAS 41 *Financial Instruments* and PBE IPSAS 36 based on the assumptions presented. The entity applies PBE IPSAS 41 in accounting for long-term interests. The entity applies PBE IPSAS 36 to its net investment in the associate, which includes long-term interests. The analysis in this example is not intended to represent the only manner in which the requirements in PBE IPSAS 36 could be applied.

Assumptions

The investor has the following three types of interests in the associate:

(a) O Shares—ordinary shares representing a 40% ownership interest to which the investor applies the equity method. This interest is the least senior of the three interests, based on their relative priority in liquidation.

(b) P Shares—non-cumulative preference shares that form part of the net investment in the associate and that the investor measures at fair value through surplus or deficit applying PBE IPSAS 41.

(c) LT Loan—a long-term loan that forms part of the net investment in the associate and that the investor measures at amortised cost applying PBE IPSAS 41, with a stated interest rate and an effective interest rate of 5% a year. The associate makes interest-only payments to the investor each year. The LT Loan is the most senior of the three interests.

The LT Loan is not an originated credit-impaired loan. Throughout the years illustrated, there has not been any objective evidence that the net investment in the associate is impaired applying PBE IPSAS 36, nor does the LT Loan become credit-impaired applying PBE IPSAS 41.

The associate does not have any outstanding cumulative preference shares classified as equity, as described in paragraph 40 of PBE IPSAS 36. Throughout the years illustrated, the associate neither declares nor pays dividends on O Shares or P Shares.

The investor has not incurred any legal or constructive obligations, nor made payments on behalf of the associate, as described in paragraph 42 of PBE IPSAS 36. Accordingly, the investor does not recognise its share of the associate's deficits once the carrying amount of its net investment in the associate is reduced to zero.

The amount of the investor's initial investment in O Shares is CU200,[*] in P Shares is CU100 and in the LT Loan is CU100. On acquisition of the investment, the cost of the investment equals the investor's share of the net fair value of the associate's identifiable assets and liabilities.

This table summarises the carrying amount at the end of each year for P Shares and the LT Loan applying PBE IPSAS 41 but before applying PBE IPSAS 36, and the associate's surplus (deficit) for each year. The amounts for the LT Loan are shown net of the loss allowance.

At the end of	**P Shares applying PBE IPSAS 41 (fair value)**	**LT Loan applying PBE IPSAS 41 (amortised cost)**	**Surplus (deficit) of the associate**
Year 1	CU110	CU90	CU50
Year 2	CU90	CU70	CU(200)
Year 3	CU50	CU50	CU(500)

At the end of	P Shares applying PBE IPSAS 41 (fair value)	LT Loan applying PBE IPSAS 41 (amortised cost)	Surplus (deficit) of the associate
Year 4	CU40	CU50	CU(150)
Year 5	CU60	CU60	–
Year 6	CU80	CU70	CU500
Year 7	CU110	CU90	CU500

Analysis

Year 1

The investor recognises the following in Year 1:

Investments in the associate:		
Dr O Shares	CU200	
Dr P Shares	CU100	
Dr LT Loan	CU100	
Cr Cash		CU400
To recognise the initial investment in the associate		
Dr P Shares	CU10	
Cr Surplus or deficit		CU10
To recognise the change in fair value (CU110 − CU100)		
Dr Surplus or deficit	CU10	
Cr Loss allowance (LT Loan)		CU10
To recognise an increase in the loss allowance (CU90 − CU100)		
Dr O Shares	CU20	
Cr Surplus or deficit		CU20
To recognise the investor's share of the associate's surplus (CU50 × 40%)		

At the end of Year 1, the carrying amount of O Shares is CU220, P Shares is CU110 and the LT Loan (net of loss allowance) is CU90.

Year 2

The investor recognises the following in Year 2:

Dr Surplus or deficit	CU20	
Cr P Shares		CU20
To recognise the change in fair value (CU90 − CU110)		
Dr Surplus or deficit	CU20	
Cr Loss allowance (LT Loan)		CU20
To recognise an increase in the loss allowance (CU70 – CU90)		
Dr Surplus or deficit	CU80	
Cr O Shares		CU80
To recognise the investor's share of the associate's loss (CU200 × 40%)		

At the end of Year 2, the carrying amount of O Shares is CU140, P Shares is CU90 and the LT Loan (net of loss allowance) is CU70.

Year 3

Applying paragraph 20A of PBE IPSAS 36, the investor applies PBE IPSAS 41 to P Shares and the LT Loan before it applies paragraph 41 of PBE IPSAS 41. Accordingly, the investor recognises the following in Year 3:

Dr Surplus or deficit	CU40	
Cr P Shares		CU40
To recognise the change in fair value (CU50 − CU90)		
Dr Surplus or deficit	CU20	
Cr Loss allowance (LT Loan)		CU20
To recognise an increase in the loss allowance (CU50 – CU70)		
Dr Surplus or deficit	CU200	
Cr O Shares		CU140
Cr P Shares		CU50
Cr LT Loan		CU10
To recognise the investor's share of the associate's deficit in reverse order of seniority as specified in paragraph 41 of PBE IPSAS 36 (CU500 × 40%)		

At the end of Year 3, the carrying amount of O Shares is zero, P Shares is zero and the LT Loan (net of loss allowance) is CU40.

Year 4

Applying PBE IPSAS 41 to its interests in the associate, the investor recognises the following in Year 4:

Dr Surplus or deficit	CU10	
Cr P Shares		CU10
To recognise the change in fair value (CU40 − CU50)		

Recognition of the change in fair value of CU10 in Year 4 results in the carrying amount of P Shares being negative CU10. Consequently, the investor recognises the following to reverse a portion of the associate's deficits previously allocated to P Shares:

Dr P Shares	CU10	
Cr Surplus or deficit		CU10
To reverse a portion of the associate's deficits previously allocated to P Shares		

Applying paragraph 41 of PBE IPSAS 36, the investor limits the recognition of the associate's deficits to CU40 because the carrying amount of its net investment in the associate is then zero. Accordingly, the investor recognises the following:

Dr Surplus or deficit	CU40	
Cr LT Loan		CU40
To recognise the investor's share of the associate's deficit		

At the end of Year 4, the carrying amount of O Shares is zero, P Shares is zero and the LT Loan (net of loss allowance) is zero. There is also an unrecognised share of the associate's deficits of CU30 (the investor's share of the associate's cumulative deficits of CU340 – CU320 deficits recognised cumulatively + CU10 deficits reversed).

Year 5

Applying PBE IPSAS 41 to its interests in the associate, the investor recognises the following in Year 5:

Dr P Shares	CU20	
Cr Surplus or deficit		CU20
To recognise the change in fair value (CU60 − CU40)		
Dr Loss allowance (LT Loan)	CU10	
Cr Surplus or deficit		CU10
To recognise a decrease in the loss allowance (CU60 – CU50)		

After applying PBE IPSAS 41 to P Shares and the LT Loan, these interests have a positive carrying amount. Consequently, the investor allocates the previously unrecognised share of the associate's deficits of CU30 to these interests.

Dr Surplus or deficit	CU30	
Cr P Shares		CU20
Cr LT Loan		CU10
To recognise the previously unrecognised share of the associate's deficits		

At the end of Year 5, the carrying amount of O Shares is zero, P Shares is zero and the LT Loan (net of loss allowance) is zero.

Year 6

Applying PBE IPSAS 41 to its interests in the associate, the investor recognises the following in Year 6:

Dr P Shares	CU20	
Cr Surplus or deficit		CU20
To recognise the change in fair value (CU80 − CU60)		
Dr Loss allowance (LT Loan)	CU10	
Cr Surplus or deficit		CU10
To recognise a decrease in the loss allowance (CU70 – CU60)		

The investor allocates the associate's surplus to each interest in the order of seniority. The investor limits the amount of the associate's surplus it allocates to P Shares and the LT Loan to the amount of equity method deficits previously allocated to those interests, which in this example is CU60 for both interests.

Dr O Shares	CU80	
Dr P Shares	CU60	
Dr LT Loan	CU60	
Cr Surplus or deficit		CU200
To recognise the investor's share of the associate's surplus (CU500 × 40%)		

At the end of Year 6, the carrying amount of O Shares is CU80, P Shares is CU80 and the LT Loan (net of loss allowance) is CU70.

Year 7

The investor recognises the following in Year 7:

Dr P Shares	CU30	
Cr Surplus or deficit		CU30
To recognise the change in fair value (CU110 − CU80)		
Dr Loss allowance (LT Loan)	CU20	
Cr Surplus or deficit		CU20
To recognise a decrease in the loss allowance (CU90 – CU70)		

Dr O Shares CU200

Cr Surplus or deficit CU200

To recognise the investor's share of the associate's surplus (CU500 × 40%)

At the end of Year 7, the carrying amount of O Shares is CU280, P Shares is CU110 and the LT Loan (net of loss allowance) is CU90.

Years 1–7

When recognising interest revenue on the LT Loan in each year, the investor does not take account of any adjustments to the carrying amount of the LT Loan that arose from applying PBE IPSAS 36 (paragraph 20A of PBE IPSAS 36). Accordingly, the investor recognises the following in each year:

Dr Cash CU5

Cr Surplus or deficit CU5

To recognise interest revenue on LT Loan based on the effective interest rate of 5%

Summary of amounts recognised in surplus or deficit

This table summarises the amounts recognised in the investor's surplus or deficit.

Items recognised / **During**	**Impairment (losses), including reversals, applying PBE IPSAS 41**	**Gains (losses) of P Shares applying PBE IPSAS 41**	**Share of surplus (deficit) of the associate recognised applying the equity method**	**Interest revenue applying PBE IPSAS 41**
Year 1	CU(10)	CU10	CU20	CU5
Year 2	CU(20)	CU(20)	CU(80)	CU5
Year 3	CU(20)	CU(40)	CU(200)	CU5
Year 4	–	CU(10)	CU(30)	CU5
Year 5	CU10	CU20	CU(30)	CU5
Year 6	CU10	CU20	CU200	CU5
Year 7	CU20	CU30	CU200	CU5

* In this Illustrative Example, currency amounts are denominated in currency units (CU).

PBE IPSAS 37 *Joint Arrangements*

Paragraphs 28, 30, 41 and 43.1 are amended. Paragraph 43.4 is added. New text is underlined and deleted text is struck through.

28. **A party that participates in, but does not have joint control of, a joint venture shall account for its interest in the arrangement in accordance with the PBE Standards dealing with financial instruments, being PBE IPSAS 28 *Financial Instruments: Presentation*, ~~PBE IPSAS 29 *Financial Instruments: Recognition and Measurement* and~~ PBE IPSAS 30 *Financial Instruments: Disclosures* and PBE IPSAS 41 *Financial Instruments* unless it has significant influence over the joint venture, in which case it shall account for it in accordance with PBE IPSAS 36.**

…

30. **In its separate financial statements, a party that participates in, but does not have joint control of, a joint arrangement shall account for its interest in:**

(a) **A joint operation in accordance with paragraph 26; and**

(b) **A joint venture in accordance with ~~PBE IPSAS 29~~ PBE IPSAS 41, unless the entity has significant influence over the joint venture, in which case it shall apply paragraph 12 of PBE IPSAS 34.**

…

41. **An entity that, in accordance with paragraph 58 of PBE IPSAS 6 *Consolidated and Separate Financial Statements,* was previously accounting in its separate financial statements for its interest in a joint operation as an investment using the equity method, at cost or in accordance with ~~PBE IPSAS 29~~ PBE IPSAS 41 shall:**

(a) Derecognise the investment and recognise the assets and the liabilities in respect of its interest in the joint operation at the amounts determined in accordance with paragraphs 37-39.

(b) Provide a reconciliation between the investment derecognised, and the assets and liabilities recognised, together with any remaining difference adjusted in accumulated surplus or deficit, at the beginning of the immediately preceding period.

…

43.1 **PBE IFRS 9 *Financial Instruments*, issued in January 2017, amended paragraphs 28, 30, 41, AG11 and AG33.1. An entity shall apply those amendments when it applies PBE IFRS 9.***

* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.

…

43.4 **PBE IPSAS 41, issued in March 2019, amended paragraphs 28, 30, 41, 43.1, AG11 and AG33.1 (and renumbered AG33.1 as AG31.A). An entity shall apply those amendments when it applies PBE IPSAS 41.**

Paragraphs AG11 and AG33.1 are amended. Paragraph AG33.1 is renumbered as AG31.A.
New text is underlined and deleted text is struck through.

AG11. When an arrangement is outside the scope of PBE IPSAS 37 *Joint Arrangements,* an entity accounts for its interest in the arrangement in accordance with relevant PBE Standards, such as PBE IPSAS 35, PBE IPSAS 36 *Investments in Associates and Joint Ventures* or PBE IPSAS 41 *Financial Instruments* ~~PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*~~.

…

AG33~~.1~~A When an entity acquires an interest in a joint operation ….:

(a) …

(b) Recognising acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with the exception that the costs to issue debt or equity securities are recognised in accordance with PBE IPSAS 28 and PBE IPSAS 41 ~~PBE IPSAS 29~~;

(c) …

PBE IPSAS 38 *Disclosure of Interests in Other Entities*

Paragraphs 4 and 61.2 are amended. Paragraph 61.5 is added. New text is underlined and deleted text is struck through.

4. **This Standard does not apply to:**

   (a) …

   …

   (d) **An interest in another entity that is accounted for in accordance with PBE IPSAS 41 *Financial Instruments* ~~PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*~~. However, an entity shall apply this Standard:**

   (i) **When that interest is an interest in an associate or a joint venture that, in accordance with PBE IPSAS 36 *Investments in Associates and Joint Ventures*, is measured at fair value through surplus or deficit; or**

   (ii) **When that interest is an interest in a structured entity that is not consolidated.**

…

61.2 **PBE IFRS 9 *Financial Instruments*, issued in January 2017, amended paragraph 4. An entity shall apply those amendments when it applies PBE IFRS 9.***

* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.

…

61.5 **PBE IPSAS 41, issued in March 2019, amended paragraphs 4 and 61.2. An entity shall apply those amendments when it applies PBE IPSAS 41.**

PBE IFRS 3 *Business Combinations*

Paragraphs 16, 42, 53, 56, 58 and 64.5 are amended. Paragraph 64.8 is added. New text is underlined and deleted text is struck through.

16. In some situations, PBE Standards provide for different accounting depending on how an entity classifies or designates a particular asset or liability. Examples of classifications or designations that the acquirer shall make on the basis of the pertinent conditions as they exist at the acquisition date include but are not limited to:

   (a) Classification of particular financial assets and liabilities as measured ~~a financial asset or liability~~ at fair value through surplus or deficit or at amortised cost, or as a financial asset measured at fair value through other comprehensive revenue and expense ~~available for sale or held to maturity~~, in accordance with PBE IPSAS 41 *Financial Instruments* ~~PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*~~;

   (b) Designation of a derivative instrument as a hedging instrument in accordance with PBE IPSAS 41 ~~PBE IPSAS 29~~; and

   (c) Assessment of whether an embedded derivative should be separated from ~~the~~a host contract in accordance with PBE IPSAS 41 ~~PBE IPSAS 29~~ (which is a matter of 'classification' as this Standard uses that term).

…

42. In a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in surplus or deficit or other comprehensive revenue and expense, as appropriate. In prior reporting periods, the acquirer may have recognised changes in the value of its equity interest in the acquiree in other comprehensive revenue and expense ~~(for example, because the investment was classified as available for sale)~~. If so, the amount that was recognised in other comprehensive revenue and expense shall be

recognised on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest.

…

53. Acquisition-related costs are costs the acquirer incurs to effect a business combination. Those costs include finder's fees; advisory, legal, accounting, valuation and other professional or consulting fees; general administrative costs, including the costs of maintaining an internal acquisitions department; and costs of registering and issuing debt and equity securities. The acquirer shall account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception. The costs to issue debt or equity securities shall be recognised in accordance with PBE IPSAS 28 and PBE IPSAS 41 ~~PBE IPSAS 29~~.

…

56. After initial recognition and until the liability is settled, cancelled or expires, the acquirer shall measure a contingent liability recognised in a business combination at the higher of:

(a) The amount that would be recognised in accordance with PBE IPSAS 19; and

(b) The amount initially recognised less, if appropriate, cumulative amortisation recognised in accordance with PBE IPSAS 9 *Revenue from Exchange Transactions*.

This requirement does not apply to contracts accounted for in accordance with PBE IPSAS 41 ~~PBE IPSAS 29~~.

…

58. Some changes in the fair value of contingent consideration that the acquirer recognises after the acquisition date may be the result of additional information that the acquirer obtained after that date about facts and circumstances that existed at the acquisition date. Such changes are measurement period adjustments in accordance with paragraphs 45–49. However, changes resulting from events after the acquisition date, such as meeting an earnings target, reaching a specified share price or reaching a milestone on a research and development project, are not measurement period adjustments. The acquirer shall account for changes in the fair value of contingent consideration that are not measurement period adjustments as follows:

(a) …

(b) Other contingent consideration that:

(i) Is within the scope of PBE IPSAS 41 ~~PBE IPSAS 29~~ shall be measured at fair value at each reporting date, and changes in fair value shall be recognised in surplus or deficit in accordance with PBE IPSAS 41 ~~that PBE Standard~~.

(ii) Is not within the scope of PBE IPSAS 41 ~~PBE IPSAS 29~~ shall be measured at fair value at each reporting date and changes in fair value shall be recognised in surplus or deficit.

…

64.5 PBE IFRS 9 *Financial Instruments*, issued in January 2017, amended paragraphs 16, 42, 53, 56, 58 and B41. An entity shall apply those amendments when it applies PBE IFRS 9.*[*]

* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.

…

64.8 PBE IPSAS 41, issued in March 2019, amended paragraphs 16, 42, 53, 56, 58, 64.5 and B41. An entity shall apply those amendments when it applies PBE IPSAS 41.

In Appendix B, paragraph B41 is amended. New text is underlined.

B41. The acquirer shall not recognise a separate valuation allowance as of the acquisition date for assets acquired in a business combination that are measured at their acquisition-date fair values because the effects of uncertainty about future cash flows are included in the fair value measure. For example, because this Standard requires the acquirer to measure acquired receivables, including loans, at their acquisition-date fair values in accounting for a business combination, the acquirer does not recognise a separate valuation allowance for the contractual cash flows that are deemed to be uncollectible at that date or a loss allowance for expected credit losses.

PBE IFRS 4 *Insurance Contracts*

Paragraphs 3, 4, 7, 8, 12, 12.1, 34, 35 and 45.5 are amended and paragraphs 45.8 and 45.9 are added:

3. This Standard does not address other aspects of accounting by insurers, such as accounting for financial assets held by insurers and financial liabilities issued by insurers (see PBE IPSAS 28 *Financial Instruments: Presentation*, ~~PBE IPSAS 29 *Financial Instruments: Recognition and Measurement* and~~ PBE IPSAS 30 and PBE IPSAS 41 *Financial Instruments*), except in the transitional provisions in paragraph 45.9.

4. An entity shall not apply this Standard to:

   (a) ...

   (d) Financial guarantee contracts unless the issuer has previously applied accounting applicable to insurance contracts and adopted an accounting policy that treated financial guarantee contracts as insurance contracts, or the entity previously did not apply accounting applicable to insurance contracts but elects to treat financial guarantee contracts as insurance contracts on adoption of PBE IPSAS 28. In such cases the issuer may elect to apply either PBE IPSAS 28, PBE IPSAS 30 and PBE IPSAS 41 ~~PBE IPSAS 29 and PBE IPSAS 28~~ or this Standard to such financial guarantee contracts. The issuer may make that election contract by contract, but the election for each contract is irrevocable.

   (e) ...

…

7. PBE IPSAS 41 ~~PBE IPSAS 29~~ requires an entity to separate some embedded derivatives from their host contract, measure them at fair value and include changes in their fair value in surplus or deficit. PBE IPSAS 41 ~~PBE IPSAS 29~~ applies to derivatives embedded in an insurance contract unless the embedded derivative is itself an insurance contract

8. As an exception to the requirement in PBE IPSAS 41 ~~PBE IPSAS 29~~, an insurer need not separate, and measure at fair value, a policyholder's option to surrender an insurance contract for a fixed amount (or for an amount based on a fixed amount and an interest rate), even if the exercise price differs from the carrying amount of the host insurance liability. However, the requirements in PBE IPSAS 41 ~~PBE IPSAS 29~~ do ~~does~~ apply to a put option or cash surrender option embedded in an insurance contract if the surrender value varies in response to the change in a financial variable (such as an equity or commodity price or index), or a non-financial variable that is not specific to a party to the contract. Furthermore, those ~~that~~ requirements also apply ~~applies~~ if the holder's ability to exercise a put option or cash surrender option is triggered by a change in such a variable (for example, a put option that can be exercised if a stock market index reaches a specified level).

…

12. To unbundle a contract, an insurer shall:

   (a) Apply this Standard to the insurance component.

   (b) Apply PBE IPSAS 41 ~~PBE IPSAS 29~~ to the deposit component.

12.1 **The following terms are used in this Standard with the meanings specified:**

…

A deposit component is a contractual component that is not accounted for as a derivative under PBE IPSAS 41 ~~PBE IPSAS 29~~ and would be within the scope of PBE IPSAS 41 ~~PBE IPSAS 29~~ if it were a separate instrument.

…

A life investment contract is a contract which is not an insurance contract but is issued by life insurers, and gives rise to a financial asset and financial liability (as defined by PBE IPSAS 41 ~~PBE IPSAS 29~~). An investment contract cannot be a contract exempted from the definition of an insurance contract as found in paragraph 4 of this Standard.

…

34. Some insurance contracts contain a discretionary participation feature as well as a *guaranteed element*. The issuer of such a contract:

(a) ...

(d) shall, if the contract contains an embedded derivative within the scope of PBE IPSAS 41 ~~PBE IPSAS 29~~, apply PBE IPSAS 41 ~~PBE IPSAS 39~~ to that embedded derivative.

(e) ...

Discretionary Participation Features in Financial Instruments

35. The requirements in paragraph 34 also apply to a financial instrument that contains a discretionary participation feature. In addition:

(a) If the issuer classifies the entire discretionary participation feature as a liability, it shall apply the liability adequacy test in paragraphs 15–19 to the whole contract (i.e., both the guaranteed element and the discretionary participation feature). The issuer need not determine the amount that would result from applying PBE IPSAS 41 ~~PBE IPSAS 29~~ to the guaranteed element.

(b) If the issuer classifies part or all of that feature as a separate component of net assets/equity, the liability recognised for the whole contract shall not be less than the amount that would result from applying PBE IPSAS 41 ~~PBE IPSAS 29~~ to the guaranteed element. That amount shall include the intrinsic value of an option to surrender the contract, but need not include its time value if paragraph 9 exempts that option from measurement at fair value. The issuer need not disclose the amount that would result from applying PBE IPSAS 41 ~~PBE IPSAS 29~~ to the guaranteed element, nor need it present that amount separately. Furthermore, the issuer need not determine that amount if the total liability recognised is clearly higher.

(c) ...

…

45.4 **PBE IFRS 9 *Financial Instruments*, issued in January 2017, amended paragraphs 3, 4, 7, 8, 12, 12.1, 34, 35 and paragraphs B18–B20 and added paragraph ~~45.3~~45.5. It also amended Appendix C paragraphs C2.2.1, C2.2.2, C10.2, C10.2.1, C10.2.2, C10.5, C10.5.1, C10.6, C10.6.1, C10.7, C10.7.1, C10.7.2, C12.1, C12.1.1, C12.1.2, C17.5.4 and C17.5.5. It also amended Appendix D paragraphs D2.2(f), D2.3.1, D2.3.2, D2.4.4, D15.2, D15.2.1, D15.2.2, D15.5, D15.5.1, D15.5.2, D16.1 and D16.1.1 and added paragraphs D16.1.2 and D16.1.3. An entity shall apply those amendments when it applies PBE IFRS 9.***

* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.

…

45.8 **PBE IPSAS 41 *Financial Instruments*, issued in March 2019, amended paragraphs 3, 4, 7, 8, 12, 12.1, 34, 35, 45.4 and paragraphs B18–B20 and added paragraph 45.9. It also amended Appendix C paragraphs C2.2.1, C2.2.2, C10.2, C10.2.1, C10.2.2, C10.5, C10.5.1, C10.6, C10.6.1, C10.7, C10.7.1, C10.7.2, C12.1, C12.1.1, C12.1.2, C17.5.4 and C17.5.5. It also amended Appendix D paragraphs D2.2(f), D2.3.1, D2.3.2, D2.4.4, D15.2, D15.2.1, D15.2.2, D15.5, D15.5.1, D15.5.2, D16.1 and D16.1.1 and added paragraphs D16.1.2 and D16.1.3. An entity shall apply those amendments when it applies PBE IPSAS 41.**

45.9 Notwithstanding paragraph 54 of PBE IPSAS 41, when an insurer changes its accounting policies for insurance liabilities, it is permitted, but not required, to reclassify some or all of its financial assets so that they are measured at fair value through surplus or deficit. This reclassification is permitted if an insurer changes accounting policies when it first applies this Standard and if it makes a subsequent policy change permitted by paragraph 22. The reclassification is a change in accounting policy and PBE IPSAS 3 applies.

D64 In Appendix B, paragraphs B18–B20 are amended to read as follows:

B18. The following are examples of contracts that are insurance contracts, if the transfer of insurance risk is significant:

(a) ...

(g) Credit insurance that provides for specified payments to be made to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due under the original or modified terms of a debt instrument. These contracts could have various legal forms, such as that of a guarantee, some types of letter of credit, a credit derivative default contract or an insurance contract. However, although these contracts meet the definition of an insurance contract, they also meet the definition of a financial guarantee contract in PBE IPSAS 41 *Financial Instruments* ~~PBE IPSAS 29~~ and are within the scope of PBE IPSAS 28 and PBE IPSAS 41 ~~PBE IPSAS 29~~, not this Standard (see paragraph 4(d)). Nevertheless, an issuer of financial guarantee contracts may have elected, in accordance with PBE IPSAS 28, to use accounting applicable to insurance contracts for such financial guarantee contracts.

(h) ...

B19. The following are examples of items that are not insurance contracts:

(a) ...

(e) Derivatives that expose one party to financial risk but not insurance risk, because they require that party to make payment based solely on changes in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (see PBE IPSAS 41 ~~PBE IPSAS 29~~).

(f) A credit-related guarantee (or letter of credit, credit derivative default contract or credit insurance contract) that requires payments even if the holder has not incurred a loss on the failure of the debtor to make payments when due (see PBE IPSAS 41 ~~PBE IPSAS 29~~).

(g) ...

B20. If the contracts described in paragraph B19 create financial assets or financial liabilities, they are within the scope of PBE IPSAS 41 ~~PBE IPSAS 29~~. Among other things, this means that the parties to the contract use what is sometimes called deposit accounting, which involves the following:

(a) ...

In PBE IFRS 4 Appendix C, paragraphs C2.2.2, C10.2, C10.5, C10.5.1, C10.6, C10.6.1, C10.7, C10.7.1, C10.7.2, C12.1, C12.1.1, C12.1.2, C17.5.4 and C17.5.5, the references to 'PBE IPSAS 29' are replaced with 'PBE IPSAS 41'.

In PBE IFRS 4 Appendix C, paragraphs C2.2.1, C10.2.1 and C10.2.2 are amended:

C2.2.1 PBE IPSAS 41 *Financial Instruments* requires hybrid contracts that contain financial asset hosts to be classified and measured in their entirety in accordance with the requirements in paragraphs 39–44 of that Standard. However, PBE IPSAS 41 ~~PBE IPSAS 29~~ ~~*Financial Instruments: Recognition and Measurement*~~ requires an entity to separate some embedded derivatives from their financial liability hosts ~~contract~~, measure them at fair value and include changes in their fair value in the statement of comprehensive revenue and expense ~~surplus or deficit~~. PBE IPSAS 41 ~~PBE IPSAS 29~~ applies to derivatives embedded in a life insurance contract unless the embedded derivative is itself a life insurance contract.

…

C10.2.1 An insurer applies PBE IPSAS 41 ~~PBE IPSAS 29~~ to its financial assets. Under PBE IPSAS 41 ~~PBE IPSAS 29~~ a financial asset is classified and measured at fair value through surplus or deficit when ~~is a financial asset that meets either of the following conditions~~:

(a) It does not meet the criteria specified in paragraph 40 of PBE IPSAS 41 to be classified at amortised cost ~~It is classified as held for trading~~; or

(b) it does not meet the criteria specified in paragraph 41 of PBE IPSAS 41 to be classified at fair value through other comprehensive revenue and expense; or (c~~b~~) It is designated as "at fair value through surplus or deficit" upon initial recognition in accordance with paragraph 44 of PBE IPSAS 41. ~~An entity may use this designation when the financial asset is a contract with an embedded derivative and paragraph 13 of PBE IFRS 9 PBE IPSAS 29 allows the entity to measure the contract as "at fair value through surplus or deficit"; or when doing so results in more relevant information, because either:~~

~~(i) It eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an "accounting mismatch") that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or~~

~~(ii) A group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel (as defined in PBE IPSAS 20 *Related Party Disclosures*), for example, the entity's governing board and chief executive officer.~~

C10.2.2 The view adopted in this Appendix is that, in all but rare cases, financial assets within the scope of PBE IPSAS 41 ~~PBE IPSAS 29~~ that back life insurance liabilities or life investment contract liabilities are permitted to be measured at fair value through surplus or deficit under PBE IPSAS 41 ~~PBE IPSAS 29~~. This is because the measurement of life insurance liabilities under this Appendix incorporates current information and measuring the financial assets backing these life insurance liabilities at fair value eliminates or significantly reduces a potential measurement or recognition inconsistency which would arise if the assets were classified ~~as available for sale or~~ and measured at amortised cost or fair value through other comprehensive revenue and expense (refer to PBE IPSAS 41 paragraph AG92(a)). ~~In addition, under PBE IPSAS 29, a group of financial assets may be designated as at fair value through surplus or deficit where it is both managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy. In the vast majority of cases, financial assets backing life investment contract liabilities and financial assets backing life insurance liabilities would be managed and their performance would be evaluated on a fair value basis, in accordance with a documented risk management or investment strategy.~~

In PBE IFRS 4 Appendix D, paragraphs D2.3.2, D2.4.4, D15.2, D15.5, D15.5.1, D15.5.2 and D16.1 the references to 'PBE IPSAS 29' are replaced with 'PBE IFRS 9'.

In PBE IFRS 4 Appendix D, paragraphs D2.2(f), D2.3.1, D15.2.1, D15.2.2 and D16.1.1 are amended and paragraphs D16.1.2 and D16.1.3 are added.

D2.2 **This Appendix does not apply to:**

(a) …

(f) **Financial guarantee contracts unless the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, in which case the issuer may elect to apply either PBE IPSAS 28 *Financial Instruments: Presentation*, ~~PBE IPSAS 29 *Financial Instruments: Recognition and Measurement* and~~ PBE IPSAS 30 *Financial Instruments: Disclosures* and PBE IPSAS 41 *Financial Instruments* or this Appendix to such financial guarantee contracts. The issuer may take that election by contract, but the election for each contract is irrevocable; and**

(g) …

…

D2.3.1 PBE IPSAS 41 *Financial Instruments* requires hybrid contracts that contain financial asset hosts to be classified and measured in their entirety in accordance with the requirements in paragraphs 39–44 of that Standard. PBE IPSAS 41 ~~PBE IPSAS 29~~ applies to derivatives embedded in a life insurance contract unless the embedded derivative is itself a life insurance contract.

…

D15.2.1 An insurer applies ~~PBE IPSAS 29~~ PBE IPSAS 41 to its financial assets. Under ~~PBE IPSAS 29~~ PBE IPSAS 41 a financial asset is classified and measured "at fair value through surplus or deficit" when ~~is a financial asset that meets either of the following conditions~~:

(a) It does not meet the criteria specified in paragraph 40 of PBE IPSAS 41 to be classified at amortised cost ~~is classified as held for trading~~; or

(b) It does not meet the criteria specified in paragraph 41 of PBE IPSAS 41 to be classified at fair value through other comprehensive revenue and expense; or

(c~~b~~) It is designated as "at fair value through surplus or deficit" upon initial recognition in accordance with paragraph 44 of PBE IPSAS 41.~~ An entity may use this designation when the financial asset is a contract with an embedded derivative and paragraph 13 of PBE IPSAS 29 allows the entity to measure the contract as "at fair value through surplus or deficit"; or when doing so results in more relevant information, because either:~~

~~(i) It eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an "accounting mismatch") that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or~~

~~(ii) A group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel (as defined in PBE IPSAS 20 *Related Party Disclosures*), for example, the entity's governing body and chief executive officer.~~

D15.2.2 The view adopted in this Appendix is that financial assets, within the scope of ~~PBE IPSAS 29~~ PBE IPSAS 41 that back general insurance liabilities, are permitted to be measured at fair value through surplus or deficit under ~~PBE IPSAS 29~~ PBE IPSAS 41. This is because the measurement of general insurance liabilities under this Appendix incorporates current information and measuring the financial assets backing these general insurance liabilities at fair value, eliminates or significantly reduces a potential measurement or recognition inconsistency which would arise if the assets were classified ~~as available for sale or~~ and measured at amortised cost or fair value through other comprehensive revenue and expense (refer to PBE IPSAS 41 paragraph AG92(a)).

…

D16.1.1 In relation to non-insurance contracts, an insurer applies ~~PBE IPSAS 29~~ PBE IPSAS 41 to its financial assets and financial liabilities. ~~Under PBE IPSAS 29 a financial asset or financial liability at fair value through surplus or deficit is a financial asset or financial liability that meets either of the following conditions:~~

~~(a) It is classified as held for trading; or~~

~~(b) It is designated as "at fair value through surplus or deficit" upon initial recognition. An entity may use this designation when the financial asset is a contract with an embedded derivative and paragraph 13 of PBE IPSAS 29 allows the entity to measure the contract as "at fair value through surplus or deficit"; or when doing so results in more relevant information, because either:~~

~~(i) It eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an "accounting mismatch") that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or~~

~~(ii) A group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel (as defined in PBE IPSAS 20 *Related Party Disclosures*), for example the entity's governing body and chief executive officer.~~

D16.1.2 Under PBE IPSAS 41 a financial asset is classified and measured at fair value through surplus or deficit when:

(a) It does not meet the criteria specified in paragraph 40 of PBE IPSAS 41 to be classified at amortised cost; or

(b) It does not meet the criteria specified in paragraph 41 of PBE IPSAS 41 to be classified at fair value through other comprehensive revenue and expense; or

(c) It is designated as "at fair value through surplus or deficit" upon initial recognition in accordance with paragraph 44 of PBE IPSAS 41.

D16.1.3 Under PBE IPSAS 41 a financial liability at fair value through surplus or deficit is a financial liability that meets either of the following conditions:

(a) It meets the definition of held for trading; or

(b) It is designated as at fair value through surplus or deficit upon initial recognition in accordance with paragraph 46 because either:

(i) It eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as 'an accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on difference bases; or

(ii) A group of financial liabilities or financial assets and financial liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel (as defined in PBE IPSAS 20 *Related Party Disclosures*), for example, the entity's governing body and chief executive officer.

An entity may also use this designation when it is a contract with an embedded derivative and paragraph 49 of PBE IPSAS 41 allows the entity to measure the hybrid contract as at fair value through surplus or deficit.

PBE IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

Paragraphs 5 and 44.5 are amended. Paragraph 44.9 is added. New text is underlined and deleted text is struck through.

5. The measurement provisions of this Standard [footnote omitted] do not apply to the following assets, which are covered by the Standards listed, either as individual assets or as part of a disposal group:

(a) ...

(c) Financial assets within the scope of PBE IPSAS 41 *Financial Instruments* ~~PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*~~.

(d) ...

…

44.5 **PBE IFRS 9 *Financial Instruments*, issued in January 2017, amended paragraph 5. An entity shall apply that amendment when it applies PBE IFRS 9.***

* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.

…

44.9 **PBE IPSAS 41, issued in March 2019, amended paragraphs 5 and 44.5. An entity shall apply those amendments when it applies PBE IPSAS 41.**

PBE IAS 12 *Income Taxes*

Paragraphs 17, 20, 59 and 98.5 are amended. Paragraph 98.9 is added. New text is underlined and deleted text is struck through.

17. Some temporary differences arise when income or expense is included in accounting profit in one period but is included in taxable profit in a different period. Such temporary differences are often described as timing differences. The following are examples of temporary differences of this kind which are taxable temporary differences and which therefore result in deferred tax liabilities:

    (a) Interest revenue is included in accounting profit in accordance with the relevant PBE Standards, ~~on a time proportion basis~~ but may, in some jurisdictions, be included in taxable profit when cash is collected. The tax base of any receivable recognised in the statement of financial position with respect to such revenues is nil because the revenues do not affect taxable profit until cash is collected;

…

20. PBE Standards permit or require certain assets to be carried at fair value or to be revalued (see, for example, PBE IPSAS 17 *Property, Plant and Equipment*, PBE IPSAS 31 *Intangible Assets*, ~~PBE IPSAS 29 *Financial Instruments: Recognition and Measurement* and~~ PBE IPSAS 16 *Investment Property* and PBE IPSAS 41 *Financial Instruments*). The revaluation or other restatement of an asset used in a taxable activity to fair value affects taxable profit (tax loss) for the current period. As a result, the tax base of the asset is adjusted and no temporary difference arises. In other jurisdictions, the revaluation or restatement of an asset does not affect taxable profit in the period of the revaluation or restatement and, consequently, the tax base of the asset is not adjusted. Nevertheless, the future recovery of the carrying amount will result in a taxable flow of economic benefits to the entity and the amount that will be deductible for tax purposes will differ from the amount of those economic benefits. The difference between the carrying amount of a revalued asset and its tax base is a temporary difference and gives rise to a deferred tax liability or asset. This is true even if:

…

59. Most deferred tax liabilities and deferred tax assets arise where revenue or expense is included in accounting profit in one period, but is included in taxable profit (tax loss) in a different period. The resulting deferred tax is recognised in surplus or deficit. Examples are when:

    (a) Interest, royalty or dividend revenue is received in arrears and is included in accounting profit ~~on a time apportionment basis~~ in accordance with PBE IPSAS 9 *Revenue from Exchange Transactions*, ~~or~~ PBE IPSAS 23 *Revenue from Non-Exchange Transactions* or PBE IPSAS 41 *Financial Instruments*, as relevant, but is included in taxable profit (tax loss) on a cash basis; and

…

98.5 **PBE IFRS 9 *Financial Instruments*, issued in January 2017, amended paragraph 20. An entity shall apply that amendment when it applies PBE IFRS 9.***

* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.

…

98.9 **PBE IPSAS 41, issued in March 2019, amended paragraphs 17, 20, 59 and 98.5. An entity shall apply that amendment when it applies PBE IPSAS 41.**

PBE IAS 34 *Interim Financial Reporting*

Paragraphs 28.1 and 49.8 are amended. Paragraph 49.12 is added. New text is underlined and deleted text is struck through.

28.1 **Application of paragraph 28 means that an entity shall not reverse an impairment loss recognised in a previous interim period in respect of goodwill ~~or an investment in either an equity instrument or a financial asset carried at cost~~. An entity shall not extend this requirement by analogy to other areas of potential conflict between PBE IAS 34 and other PBE Standards.**

…

49.8 **PBE IFRS 9 *Financial Instruments*, issued in January 2017, amended paragraph 28.1. An entity shall apply that amendment when it applies PBE IFRS 9.*~~.~~**

* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.

…

49.12 **PBE IPSAS 41 *Financial Instruments*, issued in March 2019, amended paragraphs 28.1 and 49.8. An entity shall apply those amendments when it applies PBE IPSAS 41.***

PBE FRS 45 *Service Concession Arrangements: Operator*

Paragraphs 21–23 and 30.1 are amended. Paragraph 30.2 is added. New text is underlined and deleted text is struck through.

21. PBE IPSAS 28 *Financial Instruments: Presentation,* ~~PBE IPSAS 29 *Financial Instruments: Recognition and Measurement* and~~ PBE IPSAS 30 *Financial Instruments: Disclosures* and PBE IPSAS 41 *Financial Instruments* apply to the financial asset recognised under paragraphs 14 and 16.

22. The amount due from or at the direction of the grantor is accounted for in accordance with PBE IPSAS 41 ~~PBE IPSAS 29~~ as measured at:

    (a) Amortised cost ~~A loan or receivable~~;

    (b) Fair value through other comprehensive revenue and expense ~~An available-for-sale financial asset~~; or

    (c) Fair value through surplus or deficit ~~If so designated upon initial recognition, a financial asset at fair value through surplus or deficit, if the conditions for that classification are met~~.

23. If the amount due from the grantor is measured at amortised cost or fair value through other comprehensive revenue and expense ~~accounted for either as a loan or receivable or as an available-for-sale financial asset~~, PBE IPSAS 41 ~~PBE IPSAS 29~~ requires interest calculated using the effective interest method to be recognised in surplus or deficit.

…

30.1 **PBE IFRS 9 *Financial Instruments*, issued in January 2017, amended paragraphs 21–23. An entity shall apply those amendments when it applies PBE IFRS 9.*~~.~~**

* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.

30.2 **PBE IPSAS 41, issued in March 2019, amended paragraphs 21–23 and 30.1. An entity shall apply those amendments when it applies PBE IPSAS 41.**

PBE FRS 47 *First-time Adoption of PBE Standards by Entities Other Than Those Previously Applying NZ IFRS*

Paragraphs 36 and 42.5 are amended. Paragraphs 36A, RDR 36.1 and 42.9 are added. New text is underlined and deleted text is struck through.

Designation of Financial Assets or Financial Liabilities

~~*~~36. **An entity is permitted to designate a previously recognised financial asset ~~or financial liability~~ as a financial asset ~~or financial liability~~ measured at fair value through surplus or deficit ~~or a financial asset as available for sale~~ in accordance with paragraph C16A. The entity shall disclose the fair value of financial assets ~~or financial liabilities~~ so designated ~~into each category~~ at the date of designation and their classification and carrying amount in the previous financial statements.**

36A. **An entity is permitted to designate a previously recognised financial liability as a financial liability at fair value measured through surplus or deficit in accordance with paragraph C16. The entity shall disclose the fair value of financial liabilities so designated at the date of designation and their classification and carrying amount in the previous financial statements.**

RDR36.1 **A Tier 2 entity is not required to make the disclosure required by paragraphs 36 and 36A.**

…

42.5 **PBE IFRS 9 *Financial Instruments*, issued in January 2017, amended paragraphs 36, A1–A6, C1, C11, C12, C16 and C17, and added paragraphs 36A, A8–A8G, A9, C16A–C16C, C32, E1 and E2. An entity shall apply those amendments when it applies PBE IFRS 9.*~~.~~**

* PBE IFRS 9 was subsequently withdrawn by PBE IPSAS 41. The amendments in Appendix D of PBE IFRS 9 were not compiled.

…

42.9 **PBE IPSAS 41 *Financial Instruments*, issued in March 2019, amended paragraphs 36, 42.5, A1–A6, C1, C11, C12, C16 and C17, and added paragraphs 36A, RDR36.1, A8–A8G, A9, C16A–C16C, C32, and E1 and E2. An entity shall apply those amendments when it applies PBE IPSAS 41.**

In Appendix A, paragraphs A1–A6 are amended. Paragraphs A8–A8G and A9 and related headings are added. New text is underlined and deleted text is struck through.

A1. An entity shall apply the following exceptions:

(a) Derecognition of financial assets and financial liabilities (paragraphs A2 and A3); ~~and~~

(b) Hedge accounting (paragraphs A4–A6);~~.~~

(c) Non-controlling interests (paragraph A7);

(d) Classification and measurement of financial assets (paragraphs A8–A8C);

(e) Impairment of financial assets (paragraphs A8D–A8G);

(f) Embedded derivatives (paragraph A9);

…

Derecognition of Financial Assets and Financial Liabilities

A2. Except as permitted by paragraph A3, a first-time adopter shall apply the derecognition requirements in PBE IPSAS 41 *Financial Instruments* ~~PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*~~ prospectively for transactions occurring on or after the date of transition to PBE Standards. For example, if a first-time adopter derecognised non-derivative financial assets or non-derivative financial liabilities in accordance with its previous GAAP as a result of a transaction that occurred before the date of transition to PBE Standards, it shall not recognise those assets and liabilities in accordance with PBE Standards (unless they qualify for recognition as a result of a later transaction or event).

A3. Despite ~~Notwithstanding~~ paragraph A2, an entity may apply the derecognition requirements in PBE IPSAS 41 ~~PBE IPSAS 29~~ retrospectively from a date of the entity's choosing, provided that the information needed to apply PBE IPSAS 41 ~~PBE IPSAS 29~~ to financial assets and financial liabilities derecognised as a result of past transactions was obtained at the time of initially accounting for those transactions.

Hedge Accounting

A4. As required by PBE IPSAS 41 ~~PBE IPSAS 29~~, at the date of transition to PBE Standards, an entity shall:

(a) Measure all derivatives at fair value; and

(b) Eliminate all deferred losses and gains arising on derivatives that were reported in accordance with previous GAAP as if they were assets or liabilities.

A5. An entity shall not reflect in its opening statement of financial position under PBE Standards a hedging relationship of a type that does not qualify for hedge accounting in accordance with PBE IPSAS 41 ~~PBE IPSAS 29~~ (for example, many hedging relationships where the hedging instrument is a stand-alone written option or a net written option; or where the hedged item is a net position in a cash flow hedge for another risk than foreign currency risk ~~many hedging relationships where the hedging instrument is a cash instrument or written option; or where the hedged instrument is a net position~~). However, if an entity designated a net position as a hedged item in accordance with previous GAAP, it may designate as a hedged item in accordance with PBE Standards an individual item within that net position, or a net position if that meets the requirements in paragraph 146 of PBE IPSAS 41, ~~an individual item within that net position as a hedged item in accordance with PBE Standards~~, provided that it does so no later than the date of transition to PBE Standards.

A6. If, before the date of transition to PBE Standards, an entity had designated a transaction as a hedge but the hedge does not meet the conditions for hedge accounting in PBE IPSAS 41 ~~PBE IPSAS 29~~, the entity shall apply paragraphs 135~~102~~ and 136~~112~~ of PBE IPSAS 41~~PBE IPSAS 29~~ to discontinue hedge accounting. Transactions entered into before the date of transition to PBE Standards shall not be retrospectively designated as hedges.

…

Classification and Measurement of Financial Instruments

A8. An entity shall assess whether a financial asset meets the conditions in paragraph 40 of PBE IPSAS 41 or the conditions in paragraph 41 of PBE IPSAS 41 on the basis of the facts and circumstances that exist at the date of transition to PBE Standards.

A8A. If it is impracticable to assess a modified time value of money element in accordance with paragraphs AG68–AG70 of PBE IPSAS 41 on the basis of the facts and circumstances that exist at the date of transition to PBE Standards, an entity shall assess the contractual cash flow characteristics of that financial asset on the basis of the facts and circumstances that existed at the date of transition to PBE Standards without taking into account the requirements related to the modification of the time value of money element in paragraphs AG68–AG70 of PBE IPSAS 41. (In this case, the entity shall also apply paragraph 49R of PBE IPSAS 30 but references to 'paragraph 160 of PBE IPSAS 41' shall be read to mean this paragraph and references to 'initial recognition of the financial asset' shall be read to mean 'at the date of transition to PBE Standards'.)

A8B. If it is impracticable to assess whether the fair value of a prepayment feature is insignificant in accordance with paragraph AG74 of PBE IPSAS 41 on the basis of the facts and circumstances that exist at the date of transition to PBE Standards, an entity shall assess the contractual cash flow characteristics of that financial asset on the basis of the facts and circumstances that existed at the date of transition to PBE Standards without taking into account the exception for prepayment features in paragraph AG74 of PBE IPSAS 41. (In this case, the entity shall also apply paragraph 49S of PBE IPSAS 30 but references to 'paragraph 161 of PBE IPSAS 41' shall be read to mean this paragraph and references to 'initial recognition of the financial asset' shall be read to mean 'at the date of transition to PBE Standards'.)

A8C. If it is impracticable (as defined in PBE IPSAS 3) for an entity to apply retrospectively the effective interest method in PBE IPSAS 41, the fair value of the financial asset or the financial liability at the date of transition to PBE Standards shall be the new gross carrying amount of that financial asset or the new amortised cost of that financial liability at the date of transition to PBE Standards.

Impairment of Financial Assets

A8D. An entity shall apply the impairment requirements in paragraphs 57–112 of PBE IPSAS 41 retrospectively subject to paragraphs A8E–A8G and E1–E2.

A8E. At the date of transition to PBE Standards, an entity shall use reasonable and supportable information that is available without undue cost or effort to determine the credit risk at the date that financial instruments were initially recognised (or for loan commitments and financial guarantee contracts the date that the entity became a party to the irrevocable commitment in accordance with paragraph 78 of PBE IPSAS 41) and compare that to the credit risk at the date of transition to PBE Standards (also see paragraphs AG350–AG351 of PBE IPSAS 41).

A8F. When determining whether there has been a significant increase in credit risk since initial recognition, an entity may apply:

(a) The requirements in paragraph 82 and AG186–AG188 of PBE IPSAS 41; and

(b) The rebuttable presumption in paragraph 83 of PBE IPSAS 41 for contractual payments that are more than 30 days past due if an entity will apply the impairment requirements by identifying significant increases in credit risk since initial recognition for those financial instruments on the basis of past due information.

A8G. If, at the date of transition to PBE Standards, determining whether there has been a significant increase in credit risk since the initial recognition of a financial instrument would require undue cost or effort, an entity shall recognise a loss allowance at an amount equal to lifetime expected credit losses at each reporting date until that financial instrument is derecognised (unless that financial instrument is low credit risk at a reporting date, in which case paragraph A8F(a) applies).

Embedded Derivatives

A9. A first-time adopter shall assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative on the basis of the conditions that existed at the later of the date it first became a party to the contract and the date a reassessment is required by paragraph AG109 of PBE IPSAS 41.

In Appendix C, paragraphs C1, C11, C12, C16 and C17 are amended and paragraphs C16A–C16C and, after paragraph C31, a heading and paragraph C32 are added. New text is underlined and deleted text is struck through.

C1. An entity may elect to use one or more of the following exemptions:

(a) …

(h) Designation of previously recognised financial instruments (paragraphs C16–C16C);

(i) …

(s) Designation of contracts to buy or sell a non-financial item (paragraph C32).

An entity shall not apply these exemptions by analogy to other items.

…

C11. When an entity prepares separate financial statements, PBE IPSAS 34 *Separate Financial Statements* requires it to account for its investments in controlled entities, joint ventures and associates either:

(a) Using the equity method as described in PBE IPSAS 36;

(b) At cost; or

(c) As a financial instrument in accordance with PBE IPSAS 41 *Financial Instruments* ~~PBE IPSAS 29~~.

C12. If a first-time adopter measures such an investment at cost in accordance with PBE IPSAS 34~~35~~, it shall measure that investment at one of the following amounts in its separate opening statement of financial position under PBE Standards:

(a) Cost determined in accordance with PBE IPSAS 34~~35~~; or

(b) Deemed cost. The deemed cost of such an investment shall be its:

(i) Fair value (determined in accordance with PBE IPSAS 41 ~~PBE IPSAS 29~~) at the entity's date of transition to PBE Standards in its separate financial statements; or

(ii) Previous GAAP carrying amount at that date.

A first-time adopter may choose either (i) or (ii) above to measure its investment in each controlled entity, joint venture or associate that it elects to measure using a deemed cost.

Designation of Previously Recognised Financial Instruments

C16. PBE IPSAS 41 ~~PBE IPSAS 29~~ permits a financial liability (provided it meets certain criteria) ~~asset~~ to be designated as a financial liability at fair value through surplus or deficit. Despite this requirement an entity is permitted to designate, at the date of transition to PBE Standards, any financial liability as at fair value through surplus or deficit provided the liability meets the criteria in paragraph 46 of PBE IPSAS 41 at that date. ~~on initial recognition as available-for-sale or a financial instrument (provided it meets certain criteria) to be designated as a financial asset or financial liability at fair value through surplus or deficit. Despite this requirement exceptions apply in the following circumstances:~~

~~(a) An entity is permitted to make an available-for-sale designation at the date of transition to PBE Standards.~~

~~(b) An entity is permitted to designate, at the date of transition to PBE Standards, any financial asset or financial liability as at fair value through surplus or deficit provided the asset or liability meets the criteria in paragraphs 10 or 13 of PBE IPSAS 29 at that date.~~

C16A. An entity may designate a financial asset as measured at fair value through surplus or deficit in accordance with paragraph 44 of PBE IPSAS 41 on the basis of the facts and circumstances that exist at the date of transition to PBE Standards.

C16B. An entity may designate an investment in an equity instrument as at fair value through other comprehensive revenue and expense in accordance with paragraph 106 of PBE IPSAS 41 on the basis of the facts and circumstances that exist at the date of transition to PBE Standards.

C16C. For a financial liability that is designated as a financial liability at fair value through surplus or deficit, an entity shall determine whether the treatment in paragraph 108 of PBE IPSAS 41 would create an accounting mismatch in surplus or deficit on the basis of the facts and circumstances that exist at the date of transition to PBE Standards.

Fair Value Measurement of Financial Assets or Financial Liabilities at Initial Recognition

C17. Despite ~~Notwithstanding~~ the requirements of paragraphs 11~~7~~ and 13~~9~~, an entity may apply the requirements in ~~the last sentence of~~ paragraph AG117(b)~~AG108 and in paragraph AG109~~ of PBE IPSAS 41~~PBE IPSAS 29~~ prospectively to transactions entered into on or after the date of transition to PBE Standards.

…

Designation of Contracts to Buy or Sell a Non-financial Item

C32. PBE IPSAS 41 permits some contracts to buy or sell a non-financial item to be designated at inception as measured at fair value through surplus or deficit (see paragraph 6 of PBE IPSAS 41). Despite this requirement an entity is permitted to designate, at the date of transition to PBE Standards, contracts that already exist on that date as measured at fair value through surplus or deficit but only if they meet the requirements of paragraph 6 of PBE IPSAS 41 at that date and the entity designates all similar contracts.

Appendix E is added. In Appendix E, a heading and paragraphs E1 and E2 are added. New text is underlined.

Appendix E

Short-term exemptions from PBE Standards

E1. If an entity's first PBE Standards reporting period begins before 1 January 2023 and the entity applies PBE IPSAS 41 *Financial Instruments*, the comparative information in the entity's first set of financial statements under PBE Standards need not comply with PBE IPSAS 30 *Financial Instruments: Disclosures* or PBE IPSAS 41, to the extent that the disclosures required by PBE IPSAS 30 relate to items within the scope of PBE IPSAS 41. For such entities, references to the 'date of transition to PBE Standards' shall mean, in the case of PBE IPSAS 30 and PBE IPSAS 41 only, the beginning of the first reporting period under PBE Standards.

E2. An entity that chooses to present comparative information that does not comply with PBE IPSAS 30 and PBE IPSAS 41 in its first year of transition shall:

(a) Apply the requirements of its previous GAAP in place of the requirements of PBE IPSAS 41 to comparative information about items within the scope of PBE IPSAS 41.

(b) Disclose this fact together with the basis used to prepare this information.

(c) Treat any adjustment between the statement of financial position at the comparative period's reporting date (i.e., the statement of financial position that includes comparative information under previous GAAP) and the statement of financial position at the start of the first reporting period under PBE Standards (i.e., the first period that includes information that complies with PBE IPSAS 30 and PBE IPSAS 41 as arising from a change in accounting policy and give the disclosures required by paragraph 33(a)–(e) and (f) of PBE IPSAS 3. Paragraph 33(f) applies only to amounts presented in the statement of financial position at the comparative period's reporting date.

(d) Apply paragraph 29(c) of PBE IPSAS 1 to provide additional disclosures when compliance with the specific requirements in PBE Standards is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

XRB A1 Application of the Accounting Standards Framework

Appendix C is amended. New text is underlined. Deleted text is struck through.

Accounting Standards

…

PBE IFRS 9 *Financial Instruments* (superseded on adoption of PBE IPSAS 41)

…

PBE IPSAS 41 *Financial Instruments*

PBE SFR–A (NFP) *Public Benefit Entity Simple Format Reporting–Accrual (Not-For-Profit)*

Paragraph 7 is amended and paragraph 15 is added. New text is underlined and deleted text is struck through.

7. An entity that is eligible to apply this Standard, and elects to do so, may elect to apply the requirements of a PBE Standard that is part of the Tier 2 PBE Accounting Requirements to a specific type of transaction, as long as it applies that option to all transactions of that type. For example, an entity may decide to opt up to PBE IPSAS 17 *Property, Plant and Equipment* for a class of assets, such as buildings, so that it can revalue that class of assets, or an entity may decide to opt up to the financial instruments standards (PBE IPSAS 28 *Financial Instruments: Presentation*, PBE IPSAS 29 *Financial Instruments: Recognition and Measurement* <u>(in limited circumstances),</u> (~~or PBE IFRS 9 *Financial Instruments*)~~ <u>PBE IPSAS 41 *Financial Instruments*</u> and PBE IPSAS 30 *Financial Instruments: Disclosures*) for a class* of financial instruments, such as investments in shares, so that it can measure that class of financial instruments at fair value (in which case it must apply the whole standard to that class).

* [Footnote not shown]

…

Effective Date

…

<u>15. PBE IPSAS 41 *Financial Instruments*, issued in March 2019, amended paragraph 7. An entity shall apply those amendments if and when it applies PBE IPSAS 41.</u>

PBE SFR–A (PS) *Public Benefit Entity Simple Format Reporting –Accrual (Public Sector)*

Paragraph 7 is amended and paragraph 15 is added. New text is underlined and deleted text is struck through.

7. An entity that is eligible to apply this Standard, and elects to do so, may elect to apply the requirements of a PBE Standard that is part of the Tier 2 PBE Accounting Requirements to a specific type of transaction, as long as it applies that option to all transactions of that type. For example, an entity may decide to opt up to PBE IPSAS 17 *Property, Plant and Equipment* for a class of assets, such as buildings, so that it can revalue that class of assets, or an entity may decide to opt up to the financial instruments standards (PBE IPSAS 28 *Financial Instruments: Presentation*, PBE IPSAS 29 *Financial Instruments: Recognition and Measurement* <u>(in limited circumstances),</u> (~~or PBE IFRS 9 *Financial Instruments*)~~ <u>PBE IPSAS 41 *Financial Instruments*</u> and PBE IPSAS 30 *Financial Instruments: Disclosures*) for a class* of financial instruments, such as investments in shares, so that it can measure that class of financial instruments at fair value (in which case it must apply the whole standard to that class).

* [Footnote not shown]

…

Effective Date

…

<u>15. PBE IPSAS 41 *Financial Instruments*, issued in March 2019, amended paragraph 7. An entity shall apply those amendments if and when it applies PBE IPSAS 41.</u>

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, PBE IPSAS 41.

Background to the Development of IPSAS 41

BC1. In 2010 the International Public Sector Accounting Standards Board (IPSASB) issued three new standards dealing with financial instruments. These standards substantially aligned the requirements for financial instruments in IPSAS with the requirements in IFRS Standards at that time. However, the IPSASB was aware that the IASB was in the process of updating the requirements for financial instruments and had already issued the first version of IFRS 9 *Financial Instruments*. The IPSASB was also aware that the completion of IFRS 9 could take a number of years. It therefore decided to monitor the IASB's work on IFRS 9, with the intention of initiating a project to develop a standard based on IFRS 9, once IFRS 9 had been completed.

BC2. The IASB issued the final version of IFRS 9 in July 2014. IFRS 9 introduced a number of changes to the recognition and measurement of financial instruments, including new classification and measurement requirements for financial assets, new hedging requirements and a new impairment model for financial assets. IFRS 9 was effective for annual periods beginning on or after 1 January 2018.

BC3. The IPSASB began work on a project to update its financial instrument standards in 2016 and issued IPSAS 41 *Financial Instruments*, which is substantially converged with IFRS 9, in August 2018. IPSAS 41 superseded most of the requirements in IPSAS 29 *Financial Instruments: Recognition and Measurement*. Consistent with the fact that IFRS 9 permitted entities to continue applying the hedge accounting requirements in IAS 39 *Financial Instruments Recognition and Measurement*, IPSAS 41 permitted entities to continue applying the hedge accounting requirements in IPSAS 29.

PBE IFRS 9 – An Interim Standard

BC4. In 2016 the NZASB noted that, pending the development and completion of IPSAS 41 and a PBE Standard based on IPSAS 41, for-profit entities applying NZ IFRS 9 *Financial Instruments* and PBEs applying PBE IPSAS 29 *Financial Instruments Recognition and Measurement* would be subject to different requirements. These differences were expected to have a significant impact on mixed groups with requirements to report in accordance with standards issued by the XRB.

BC5. The NZASB considered whether to wait for the IPSASB to develop a new standard based on IFRS 9 or whether to develop an interim PBE Standard based on IFRS 9 for application by PBEs. In considering these options the NZASB had regard to the *Policy Approach to Developing the Suite of PBE Standards* (*PBE Policy Approach*) and sought feedback from constituents. After careful consideration (as documented in the Basis for Conclusions on PBE IFRS 9), the NZASB decided to develop an interim PBE Standard based on IFRS 9. The NZASB issued PBE IFRS 9 *Financial Instruments* in January 2017. PBE IFRS 9 was available for early adoption but had an extended effective date (1 January 2021) in order to allow time for the IPSASB to develop a standard based on IFRS 9.[4]

BC6. The development of PBE IFRS 9 was a limited scope project intended to meet the most pressing issues that mixed groups would encounter when NZ IFRS 9 became effective. In order to minimise differences between PBE IFRS 9 and a future PBE Standard, the NZASB:

(a) incorporated the modifications that the IPSASB made when developing IPSAS 29 in PBE IFRS 9; and

(b) limited the scope of the project to the updated recognition and measurement requirements in IFRS 9. The project did not address other updated requirements (such as the more recent offsetting requirements in NZ IFRS), as the NZASB preferred to wait for the IPSASB to consider these matters.

[4] The NZASB subsequently deferred this effective date to 1 January 2022 so that PBE IFRS 9 did not become mandatorily effective before PBE IPSAS 41.

Decision to develop PBE IPSAS 41

BC7. Following the issue of IPSAS 41 in 2018 the NZASB agreed to develop a PBE Standard based on IPSAS 41 and to withdraw PBE IFRS 9. The NZASB noted that this would be in accordance with New Zealand's Accounting Standards Framework and would:

(a) substantially align the requirements in PBE Standards with the most recent IPSAS;

(b) substantially align the requirements in PBE Standards with the equivalent requirements in NZ IFRS and minimise mixed group issues; and

(c) allow entities to adopt updated hedge accounting requirements that align more closely with an entity's risk management practices and that can be applied more broadly than the hedge accounting requirements in PBE IPSAS 29.

BC8. The NZASB considered that the requirements of IPSAS 41 were generally appropriate for application by public benefit entities and followed its usual processes in modifying IPSAS 41 for application by Tier 1 and Tier 2 public benefit entities. Most of the changes made to IPSAS 41 were to ensure coherence within the suite of PBE Standards (in terms of aligning terminology and requirements with other PBE Standards). In the case of disclosure requirements added to PBE IPSAS 30 *Financial Instruments: Disclosures* as a result of this project the NZASB identified disclosure concessions for Tier 2 entities and aligned these with the disclosure concessions in NZ IFRS 7 *Financial Instruments: Disclosures.* The NZASB issued ED 2018-5 PBE IPSAS 41 *Financial Instruments* in November 2018 with comments due by 28 February 2019.

BC9. The specific modifications considered or made by the NZASB in developing PBE IPSAS 41 are outlined below.

Dividend and interest revenue

BC10. Consistent with IFRS 9, IPSAS 41 includes requirements in relation to dividend and interest revenue. However, Appendix D of IPSAS 41 did not remove the previous requirements for dividend and interest revenue from IPSAS 9 *Revenue from Exchange Transactions*. When it issued PBE IPSAS 41 the NZASB removed the dividend and interest requirements from PBE IPSAS 9 *Revenue from Exchange Transactions*, in anticipation of the IPSASB making equivalent amendments to IPSAS 9 at a future date. Respondents supported the NZASB's actions.

Transition from PBE IFRS 9

BC11. Because the majority of the requirements in the proposed PBE IPSAS 41 are identical, or almost identical, to the requirements in PBE IFRS 9, the NZASB developed~~included~~ transitional provisions to minimise the amount of effort required to transition between the two standards. The NZASB proposed that entities that had previously applied PBE IFRS 9:

(a) continue to classify, recognise and measure financial instruments in the same way – except as expressly permitted by PBE IPSAS 41;

(b) apply specific transition provisions in respect of the revised requirements such as to the designation of financial instruments with prepayment features that give rise to negative compensation;

(c) have the option of picking up the new hedge accounting requirements in PBE IPSAS 41 on adoption of PBE IPSAS 41, even if they did not pick up the new hedge accounting requirements on adoption of PBE IFRS 9. However, any entities already applying the new hedge accounting requirements in PBE IFRS 9 would be required to apply the hedge accounting requirements in PBE IPSAS 41 (using the same designations and hedge accounting relationships at the point of transition); and

(d) apply most of the revised disclosure requirements in PBE IPSAS 30 retrospectively.

BC12. Respondents supported these proposals.

Transition from PBE IPSAS 29

BC13. With respect to entities transitioning from PBE IPSAS 29 the proposed transitional provisions in ED 2018-5 were based on the provisions in IFRS 9, PBE IFRS 9 and IPSAS 41. Respondents were generally in support of the proposals, although a respondent requested that the NZASB add a specific transition provision in relation to the measurement of financial guarantee contracts issued through a non-exchange transaction whose fair value could not previously be reliably measured at initial recognition. The NZASB added a specific transition provision (paragraph 169.1) in response to this request.

ILLUSTRATIVE EXAMPLES

CONTENTS

from paragraph

Illustrative Examples

These examples accompany, but are not part of, PBE IPSAS 41.

Financial Liabilities at Fair Value Through Surplus or Deficit

IE1. The following example illustrates the calculation that an entity might perform in accordance with paragraph AG241 of PBE IPSAS 41 *Financial Instruments*.

IE2. On January 1, 20X1 an entity issues a 10-year bond with a par value of CU150,000[5] and an annual fixed coupon rate of 8 per cent, which is consistent with market rates for bonds with similar characteristics.

IE3. The entity uses LIBOR as its observable (benchmark) interest rate. At the date of inception of the bond, LIBOR is 5 per cent. At the end of the first year:

(a) LIBOR has decreased to 4.75 per cent.

(b) The fair value for the bond is CU153,811, consistent with an interest rate of 7.6 per cent.[6]

IE4. The entity assumes a flat yield curve, all changes in interest rates result from a parallel shift in the yield curve, and the changes in LIBOR are the only relevant changes in market conditions.

IE5. The entity estimates the amount of change in the fair value of the bond that is not attributable to changes in market conditions that give rise to market risk as follows:

[paragraph AG241(a)] First, the entity computes the liability's internal rate of return at the start of the period using the observed market price of the liability and the liability's contractual cash flows at the start of the period. It deducts from this rate of return the observed (benchmark) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.	At the start of the period of a 10-year bond with a coupon of 8 per cent, the bond's internal rate of return is 8 per cent. Because the observed (benchmark) interest rate (LIBOR) is 5 per cent, the instrument-specific component of the internal rate of return is 3 per cent.
[paragraph AG241(b)] Next, the entity calculates the present value of the cash flows associated with the liability using the liability's contractual cash flows at the end of the period and a discount rate equal to the sum of (i) the observed (benchmark) interest rate at the end of the period and (ii) the instrument-specific component of the internal rate of return as determined in accordance with paragraph AG241(a).	The contractual cash flows of the instrument at the end of the period are: • Interest: CU12,000[(a)] per year for each of years 2-10. • Principal: CU150,000 in year 10. The discount rate to be used to calculate the present value of the bond is thus 7.75 per cent, which is the end of period LIBOR rate of 4.75 per cent, plus the 3 per cent instrument-specific component. This gives a present value of CU152,367.[(b)]

5 In this guidance monetary amounts are denominated in 'currency units' (CU).

6 This reflects a shift in LIBOR from 5 per cent to 4.75 per cent and a movement of 0.15 per cent which, in the absence of other relevant changes in market conditions, is assumed to reflect changes in credit risk of the instrument.

[paragraph AG241(c)] The difference between the observed market price of the liability at the end of the period and the amount determined in accordance with paragraph AG241(b) is the change in fair value that is not attributable to changes in the observed (benchmark) interest rate. This is the amount to be presented in other comprehensive revenue and expense~~income~~ in accordance with paragraph 108(a).	The market price of the liability at the end of the period is CU153,811.(c) Thus, the entity presents CU1,444 in other comprehensive revenue and expense~~income~~, which is CU153,811 – CU152,367, as the increase in fair value of the bond that is not attributable to changes in market conditions that give rise to market risk.

(a) CU150,000 × 8% = CU12,000.
(b) PV = [CU12,000 × (1 – (1 + 0.0775)$^{-9}$)/0.0775] + CU150,000 × (1 + 0.0775)$^{-9}$.
(c) market price = [CU12,000 × (1 – (1 + 0.076)$^{-9}$)/0.076] + CU150,000 × (1 + 0.076)$^{-9}$.

Impairment (paragraphs 73–93)

Assessing Significant Increases in Credit Risk Since Initial Recognition

IE6. The following examples illustrate possible ways to assess whether there have been significant increases in credit risk since initial recognition. For simplicity of illustration, the following examples only show one aspect of the credit risk analysis. However, the assessment of whether lifetime expected credit losses should be recognised is a multifactor and holistic analysis that considers reasonable and supportable information that is available without undue cost or effort and that is relevant for the particular financial instrument being assessed.

Example 1—Significant Increase in Credit Risk

IE7. Company Y has a funding structure that includes a senior secured loan facility with different tranches.[7] Company Y qualifies for assistance from the National Development Bank which provides a tranche of the loan facility to Company Y. At the time of origination of the loan by the National Development Bank, although Company Y's leverage was relatively high compared with other issuers with similar credit risk, it was expected that Company Y would be able to meet the covenants for the life of the instrument. In addition, the generation of revenue and cash flow was expected to be stable in Company Y's industry over the term of the senior facility. However, there was some business risk related to the ability to grow gross margins within its existing businesses.

IE8. At initial recognition, because of the considerations outlined in paragraph IE7, the National Development Bank considers that despite the level of credit risk at initial recognition, the loan is not an originated credit-impaired loan because it does not meet the definition of a credit-impaired financial asset in paragraph 9 of PBE IPSAS 41.

IE9. Subsequent to initial recognition, macroeconomic changes have had a negative effect on total sales volume and Company Y has underperformed on its business plan for revenue generation and net cash flow generation. Although spending on inventory has increased, anticipated sales have not materialised. To increase liquidity, Company Y has drawn down more on a separate revolving credit facility, thereby increasing its leverage ratio. Consequently, Company Y is now close to breaching its covenants on the senior secured loan facility with the National Development Bank.

IE10. The National Development Bank makes an overall assessment of the credit risk on the loan to Company Y at the reporting date by taking into consideration all reasonable and supportable information that is available without undue cost or effort and that is relevant for assessing the extent of the increase in credit risk since initial recognition. This may include factors such as:

(a) The National Development Bank's expectation that the deterioration in the macroeconomic environment may continue in the near future, which is expected to have a further negative impact on Company Y's ability to generate cash flows and to deleverage.

[7] The security on the loan affects the loss that would be realised if a default occurs, but does not affect the risk of a default occurring, so it is not considered when determining whether there has been a significant increase in credit risk since initial recognition as required by paragraph 75 of PBE IPSAS 41.

(b) Company Y is closer to breaching its covenants, which may result in a need to restructure the loan or reset the covenants.

(c) The National Development Bank's assessment that the trading prices for Company Y's bonds have decreased and that the credit margin on newly originated loans have increased reflecting the increase in credit risk, and that these changes are not explained by changes in the market environment (for example, benchmark interest rates have remained unchanged). A further comparison with the pricing of Company Y's peers shows that reductions in the price of Company Y's bonds and increases in credit margin on its loans have probably been caused by company-specific factors.

(d) The National Development Bank has reassessed its internal risk grading of the loan on the basis of the information that it has available to reflect the increase in credit risk.

IE11. The National Development Bank determines that there has been a significant increase in credit risk since initial recognition of the loan in accordance with paragraph 75 of PBE IPSAS 41. Consequently, the National Development Bank recognises lifetime expected credit losses on its senior secured loan to Company Y. Even if the National Development Bank has not yet changed the internal risk grading of the loan it could still reach this conclusion—the absence or presence of a change in risk grading in itself is not determinative of whether credit risk has increased significantly since initial recognition.

Example 2—No Significant Increase in Credit Risk

IE12. Company C, is the holding company of a group that operates in a cyclical production industry. State Government B provided a loan to Company C. At that time, the prospects for the industry were positive, because of expectations of further increases in global demand. However, input prices were volatile and given the point in the cycle, a potential decrease in sales was anticipated.

IE13. In addition, in the past Company C has been focused on external growth, acquiring majority stakes in companies in related sectors. As a result, the group structure is complex and has been subject to change, making it difficult for investors to analyse the expected performance of the group and to forecast the cash that will be available at the holding company level. Even though leverage is at a level that is considered acceptable by Company C's creditors at the time that State Government B originates the loan, its creditors are concerned about Company C's ability to refinance its debt because of the short remaining life until the maturity of the current financing. There is also concern about Company C's ability to continue to service interest using the dividends it receives from its operating subsidiaries.

IE14. At the time of the origination of the loan by State Government B, Company C's leverage was in line with that of other borrowers with similar credit risk and based on projections over the expected life of the loan, the available capacity (i.e., headroom) on its coverage ratios before triggering a default event, was high. State Government B applies its own internal rating methods to determine credit risk and allocates a specific internal rating score to its loans. State Government B's internal rating categories are based on historical, current and forward-looking information and reflect the credit risk for the tenor of the loans. On initial recognition, State Government B determines that the loan is subject to considerable credit risk, has speculative elements and that the uncertainties affecting Company C, including the group's uncertain prospects for cash generation, could lead to default. However, State Government B does not consider the loan to be originated credit-impaired because it does not meet the definition of a purchased or originated credit-impaired financial asset in paragraph 9 of PBE IPSAS 41.

IE15. Subsequent to initial recognition, Company C has announced that three of its five key subsidiaries had a significant reduction in sales volume because of deteriorated market conditions but sales volumes are expected to improve in line with the anticipated cycle for the industry in the following months. The sales of the other two subsidiaries were stable. Company C has also announced a corporate restructure to streamline its operating subsidiaries. This restructuring will increase the flexibility to refinance existing debt and the ability of the operating subsidiaries to pay dividends to Company C.

IE16. Despite the expected continuing deterioration in market conditions, State Government B determines, in accordance with paragraph 75 of PBE IPSAS 41, that there has not been a significant increase in the credit risk on the loan to Company C since initial recognition. This is demonstrated by factors that include:

(a) Although current sale volumes have fallen, this was as anticipated by State Government B at initial recognition. Furthermore, sales volumes are expected to improve, in the following months.

(b) Given the increased flexibility to refinance the existing debt at the operating subsidiary level and the increased availability of dividends to Company C, State Government B views the corporate restructure as being credit enhancing. This is despite some continued concern about the ability to refinance the existing debt at the holding company level.

(c) State Government B's credit risk department, which monitors Company C, has determined that the latest developments are not significant enough to justify a change in its internal credit risk rating.

IE17. As a consequence, State Government B does not recognise a loss allowance at an amount equal to lifetime expected credit losses on the loan. However, it updates its measurement of the 12-month expected credit losses for the increased risk of a default occurring in the next 12 months and for current expectations of the credit losses that would arise if a default were to occur.

Example 3—Highly Collateralised Financial Asset

IE18. Company H owns land which is financed by a five-year loan from the State-owned Agricultural Bank with a loan-to-value (LTV) ratio of 50 per cent. The loan is secured by a first-ranking security over the land. At initial recognition of the loan, the State-owned Agricultural Bank does not consider the loan to be originated credit-impaired as defined in paragraph 9 of PBE IPSAS 41.

IE19. Subsequent to initial recognition, the revenues and operating profits of Company H have decreased because of an economic recession. Furthermore, expected increases in regulations have the potential to further negatively affect revenue and operating profit. These negative effects on Company H's operations could be significant and ongoing.

IE20. As a result of these recent events and expected adverse economic conditions, Company H's free cash flow is expected to be reduced to the point that the coverage of scheduled loan payments could become tight. The State-owned Agricultural Bank estimates that a further deterioration in cash flows may result in Company H missing a contractual payment on the loan and becoming past due.

IE21. Recent third party appraisals have indicated a decrease in the value of the land, resulting in a current LTV ratio of 70 per cent.

IE22. At the reporting date, the loan to Company H is not considered to have low credit risk in accordance with paragraph 82 of PBE IPSAS 41. The State-owned Agricultural Bank therefore needs to assess whether there has been a significant increase in credit risk since initial recognition in accordance with paragraph 75 of PBE IPSAS 41, irrespective of the value of the collateral it holds. It notes that the loan is subject to considerable credit risk at the reporting date because even a slight deterioration in cash flows could result in Company H missing a contractual payment on the loan. As a result, the State-owned Agricultural Bank determines that the credit risk (i.e., the risk of a default occurring) has increased significantly since initial recognition. Consequently, the State-owned Agricultural Bank recognises lifetime expected credit losses on the loan to Company H.

IE23. Although lifetime expected credit losses should be recognised, the measurement of the expected credit losses will reflect the recovery expected from the collateral (adjusting for the costs of obtaining and selling the collateral) on the property as required by paragraph AG219 of PBE IPSAS 41 and may result in the expected credit losses on the loan being very small.

Example 4—Public Investment-Grade Bond

IE24. Company A is a large listed national logistics company. The only debt in the capital structure is a five-year public bond with a restriction on further borrowing as the only bond covenant. Company A reports quarterly to its shareholders. The National Public Investment Fund is one of many investors in the bond. The Investment Fund considers the bond to have low credit risk at initial recognition in accordance with paragraph 82 of PBE IPSAS 41. This is because the bond has a low risk of default and Company A is considered to have a strong capacity to meet its obligations in the near term. The Investment Fund's expectations for the longer term are that adverse changes in economic and business conditions may, but will not necessarily, reduce Company A's ability to fulfil its obligations on the bond. In addition, at initial recognition the bond had an internal credit rating that is correlated to a global external credit rating of investment grade.

IE25. At the reporting date, the Investment Fund's main credit risk concern is the continuing pressure on the total volume of sales that has caused Company A's operating cash flows to decrease.

IE26. Because the Investment Fund relies only on quarterly public information and does not have access to private credit risk information (because it is a bond investor), its assessment of changes in credit risk is tied to public announcements and information, including updates on credit perspectives in press releases from rating agencies.

IE27. The Investment Fund applies the low credit risk simplification in paragraph 82 of PBE IPSAS 41. Accordingly, at the reporting date, the Investment Fund evaluates whether the bond is considered to have low credit risk using all reasonable and supportable information that is available without undue cost or effort. In making that evaluation, the Investment Fund reassesses the internal credit rating of the bond and concludes that the bond is no longer equivalent to an investment grade rating because:

(a) The latest quarterly report of Company A revealed a quarter-on-quarter decline in revenues of 20 per cent and in operating profit by 12 per cent.

(b) Rating agencies have reacted negatively to a profit warning by Company A and put the credit rating under review for possible downgrade from investment grade to non-investment grade. However, at the reporting date the external credit risk rating was unchanged.

(c) The bond price has also declined significantly, which has resulted in a higher yield to maturity. The Investment Fund assesses that the bond prices have been declining as a result of increases in Company A's credit risk. This is because the market environment has not changed (for example, benchmark interest rates, liquidity etc are unchanged) and comparison with the bond prices of peers shows that the reductions are probably company specific (instead of being, for example, changes in benchmark interest rates that are not indicative of company-specific credit risk).

IE28. While Company A currently has the capacity to meet its commitments, the large uncertainties arising from its exposure to adverse business and economic conditions have increased the risk of a default occurring on the bond. As a result of the factors described in paragraph IE27, the Investment Fund determines that the bond does not have low credit risk at the reporting date. As a result, the Investment Fund needs to determine whether the increase in credit risk since initial recognition has been significant. On the basis of its assessment, the Investment Fund determines that the credit risk has increased significantly since initial recognition and that a loss allowance at an amount equal to lifetime expected credit losses should be recognised in accordance with paragraph 75 of PBE IPSAS 41.

Example 5—Responsiveness to Changes in Credit Risk

IE29. Housing Corporation ABC provides mortgages to citizens of ABC to finance residential real estate in three different regions. The mortgage loans are originated across a wide range of LTV criteria and a wide range of income groups. As part of the mortgage application process, borrowers are required to provide information such as the industry within which the borrower is employed and the post code of the property that serves as collateral on the mortgage.

IE30. Housing Corporation ABC sets its acceptance criteria based on credit scores. Loans with a credit score above the 'acceptance level' are approved because these borrowers are considered to be able to meet contractual payment obligations. When new mortgage loans are originated, Housing Corporation ABC uses the credit score to determine the risk of a default occurring as at initial recognition.

IE31. At the reporting date Housing Corporation ABC determines that economic conditions are expected to deteriorate significantly in all regions. Unemployment levels are expected to increase while the value of residential property is expected to decrease, causing the LTV ratios to increase. As a result of the expected deterioration in economic conditions, Housing Corporation ABC expects default rates on the mortgage portfolio to increase.

Individual Assessment

IE32. In Region One, Housing Corporation ABC assesses each of its mortgage loans on a monthly basis by means of an automated behavioural scoring process. Its scoring models are based on current and historical past due statuses, levels of borrower indebtedness, LTV measures, the loan size and the time since the origination of the loan. Housing Corporation ABC updates the LTV measures on a regular basis through an automated process that re-estimates property values using recent sales in each post code area and reasonable and supportable forward-looking information that is available without undue cost or effort.

IE33. Housing Corporation ABC has historical data that indicates a strong correlation between the value of residential property and the default rates for mortgages. That is, when the value of residential property declines, a borrower has less economic incentive to make scheduled mortgage repayments, increasing the risk of a default occurring.

IE34. Through the impact of the LTV measure in the behavioural scoring model, an increased risk of a default occurring due to an expected decline in residential property value adjusts the behavioural scores. The behavioural score can be adjusted as a result of expected declines in property value even when the mortgage loan is a bullet loan with the most significant payment obligations at maturity (and beyond the next 12 months). Mortgages with a high LTV ratio are more sensitive to changes in the value of the residential property and Housing Corporation ABC is able to identify significant increases in credit risk since initial recognition on individual borrowers before a mortgage becomes past due if there has been a deterioration in the behavioural score.

IE35. When the increase in credit risk has been significant, a loss allowance at an amount equal to lifetime expected credit losses is recognised. Housing Corporation ABC measures the loss allowance by using the LTV measures to estimate the severity of the loss, i.e., the loss given default (LGD). The higher the LTV measure, the higher the expected credit losses all else being equal.

IE36. If Housing Corporation ABC was unable to update behavioural scores to reflect the expected declines in property prices, it would use reasonable and supportable information that is available without undue cost or effort to undertake a collective assessment to determine the loans on which there has been a significant increase in credit risk since initial recognition and recognise lifetime expected credit losses for those loans.

Collective Assessment

IE37. In Regions Two and Three, Housing Corporation ABC does not have an automated scoring capability. Instead, for credit risk management purposes, Housing Corporation ABC tracks the risk of a default occurring by means of past due statuses. It recognises a loss allowance at an amount equal to lifetime expected credit losses for all loans that have a past due status of more than 30 days past due. Although Housing Corporation ABC uses past due status information as the only borrower-specific information, it also considers other reasonable and supportable forward-looking information that is available without undue cost or effort to assess whether lifetime expected credit losses should be recognised on loans that are not more than 30 days past due. This is necessary in order to meet the objective in paragraph 76 of PBE IPSAS 41 of recognising lifetime expected credit losses for all significant increases in credit risk.

Region Two

IE38. Region Two includes a mining community that is largely dependent on the export of coal and related products. Housing Corporation ABC becomes aware of a significant decline in coal exports and anticipates the closure of several coal mines. Because of the expected increase in the unemployment rate, the risk of a default occurring on mortgage loans to borrowers who are employed by the coal mines is determined to have increased significantly, even if those borrowers are not past due at the reporting date. Housing Corporation ABC therefore segments its mortgage portfolio by the industry within which borrowers are employed (using the information recorded as part of the mortgage application process) to identify borrowers that rely on coal mining as the dominant source of employment (i.e., a 'bottom up' approach in which loans are identified based on a common risk characteristic). For those mortgages, Housing Corporation ABC recognises a loss allowance at an amount equal to lifetime expected credit losses while it continues to recognise a loss allowance at an amount equal to 12-month expected credit losses for all other mortgages in Region Two.[8] Newly originated mortgages to borrowers who are economically dependent on the coal mines in this community would, however, have a loss allowance at an amount equal to 12-month expected credit losses because they would not have experienced significant increases in credit risk since initial recognition. However, some of these mortgages may experience

[8] Except for those mortgages that are determined to have significantly increased in credit risk based on an individual assessment, such as those that are more than 30 days past due. Lifetime expected credit losses would also be recognised on those mortgages.

significant increases in credit risk soon after initial recognition because of the expected closure of the coal mines.

Region Three

IE39. In Region Three, Housing Corporation ABC anticipates the risk of a default occurring and thus an increase in credit risk, as a result of an expected increase in interest rates during the expected life of the mortgages. Historically, an increase in interest rates has been a lead indicator of future defaults on mortgages in Region Three—especially when borrowers do not have a fixed interest rate mortgage. Housing Corporation ABC determines that the variable interest-rate portfolio of mortgages in Region Three is homogenous and that unlike for Region Two, it is not possible to identify particular sub portfolios on the basis of shared risk characteristics that represent borrowers who are expected to have increased significantly in credit risk. However, as a result of the homogenous nature of the mortgages in Region Three, Housing Corporation ABC determines that an assessment can be made of a proportion of the overall portfolio that has significantly increased in credit risk since initial recognition (i.e., a ‘top down’ approach can be used). Based on historical information, Housing Corporation ABC estimates that an increase in interest rates of 200 basis points will cause a significant increase in credit risk on 20 per cent of the variable interest-rate portfolio. Therefore, as a result of the anticipated increase in interest rates, Housing Corporation ABC determines that the credit risk on 20 per cent of mortgages in Region Three has increased significantly since initial recognition. Accordingly Housing Corporation ABC recognises lifetime expected credit losses on 20 per cent of the variable rate mortgage portfolio and a loss allowance at an amount equal to 12-month expected credit losses for the remainder of the portfolio.[9]

Example 6—Comparison to Maximum Initial Credit Risk

IE40. The Economic Development Agency has two portfolios of small business loans with similar terms and conditions in Region W. The Economic Development Agency’s policy on financing decisions for each loan is based on an internal credit rating system that considers a borrower’s credit history, payment behaviour and other factors, and assigns an internal credit risk rating from 1 (lowest credit risk) to 10 (highest credit risk) to each loan on origination. The risk of a default occurring increases exponentially as the credit risk rating deteriorates so, for example, the difference between credit risk rating grades 1 and 2 is smaller than the difference between credit risk rating grades 2 and 3. Loans in Portfolio 1 were only offered to repeat borrowers with a similar internal credit risk rating and at initial recognition all loans were rated 3 or 4 on the internal rating scale. The Economic Development Agency determines that the maximum initial credit risk rating at initial recognition it would accept for Portfolio 1 is an internal rating of 4. Loans in Portfolio 2 were offered to borrowers that responded to an advertisement for small business loans and the internal credit risk ratings of these borrowers range between 4 and 7 on the internal rating scale. The Economic Development Agency never originates a small business loan with an internal credit risk rating worse than 7 (i.e., with an internal rating of 8–10).

IE41. For the purposes of assessing whether there have been significant increases in credit risk, the Economic Development Agency determines that all loans in Portfolio 1 had a similar initial credit risk. It determines that given the risk of default reflected in its internal risk rating grades, a change in internal rating from 3 to 4 would not represent a significant increase in credit risk but that there has been a significant increase in credit risk on any loan in this portfolio that has an internal rating worse than 5. This means that the Department of Finance does not have to know the initial credit rating of each loan in the portfolio to assess the change in credit risk since initial recognition. It only has to determine whether the credit risk is worse than 5 at the reporting date to determine whether lifetime expected credit losses should be recognised in accordance with paragraph 75 of PBE IPSAS 41.

IE42. However, determining the maximum initial credit risk accepted at initial recognition for Portfolio 2 at an internal credit risk rating of 7, would not meet the objective of the requirements as stated in paragraph 76 of PBE IPSAS 41. This is because the Economic Development Agency determines that significant increases in credit risk arise not only when credit risk increases above the level at which an entity would originate new financial assets (i.e., when the internal rating is worse than 7). Although the Economic Development Agency never originates a small business loan with an internal credit rating worse than 7, the initial credit risk on loans in Portfolio 2 is not of sufficiently similar credit risk at initial recognition

[9] Except for those mortgages that are determined to have significantly increased in credit risk based on an individual assessment, such as those that are more than 30 days past due. Lifetime expected credit losses would also be recognised on those mortgages.

to apply the approach used for Portfolio 1. This means that the Economic Development Agency cannot simply compare the credit risk at the reporting date with the lowest credit quality at initial recognition (for example, by comparing the internal credit risk rating of loans in Portfolio 2 with an internal credit risk rating of 7) to determine whether credit risk has increased significantly because the initial credit quality of loans in the portfolio is too diverse. For example, if a loan initially had a credit risk rating of 4 the credit risk on the loan may have increased significantly if its internal credit risk rating changes to 6.

Example 7—Counterparty Assessment of Credit Risk

Scenario 1

IE43. In 20X0 the Infrastructure Bank of Country A granted a loan of CU10,000 with a contractual term of 15 years to Company Q when the company had an internal credit risk rating of 4 on a scale of 1 (lowest credit risk) to 10 (highest credit risk). The risk of a default occurring increases exponentially as the credit risk rating deteriorates so, for example, the difference between credit risk rating grades 1 and 2 is smaller than the difference between credit risk rating grades 2 and 3. In 20X5, when Company Q had an internal credit risk rating of 6, the Infrastructure Bank issued another loan to Company Q for CU5,000 with a contractual term of 10 years. In 20X7 Company Q fails to retain its contract with a major customer and correspondingly experiences a large decline in its revenue. The Infrastructure Bank considers that as a result of losing the contract, Company Q will have a significantly reduced ability to meet its loan obligations and changes its internal credit risk rating to 8.

IE44. The Infrastructure Bank assesses credit risk on a counterparty level for credit risk management purposes and determines that the increase in Company Q's credit risk is significant. Although the Infrastructure Bank did not perform an individual assessment of changes in the credit risk on each loan since its initial recognition, assessing the credit risk on a counterparty level and recognising lifetime expected credit losses on all loans granted to Company Q, meets the objective of the impairment requirements as stated in paragraph 76 of PBE IPSAS 41. This is because, even since the most recent loan was originated (in 20X7) when Company Q had the highest credit risk at loan origination, its credit risk has increased significantly. The counterparty assessment would therefore achieve the same result as assessing the change in credit risk for each loan individually.

Scenario 2

IE45. The Infrastructure Bank of Country A granted a loan of CU150,000 with a contractual term of 20 years to Company X in 20X0 when the company had an internal credit risk rating of 4. During 20X5 economic conditions deteriorate and demand for Company X's products has declined significantly. As a result of the reduced cash flows from lower sales, Company X could not make full payment of its loan instalment to the Infrastructure Bank. The Infrastructure Bank re-assesses Company X's internal credit risk rating, and determines it to be 7 at the reporting date. The Infrastructure Bank considered the change in credit risk on the loan, including considering the change in the internal credit risk rating, and determines that there has been a significant increase in credit risk and recognises lifetime expected credit losses on the loan of CU150,000.

IE46. Despite the recent downgrade of the internal credit risk rating, the Infrastructure Bank grants another loan of CU50,000 to Company X in 20X6 with a contractual term of 5 years, taking into consideration the higher credit risk at that date.

IE47. The fact that Company X's credit risk (assessed on a counterparty basis) has previously been assessed to have increased significantly, does not result in lifetime expected credit losses being recognised on the new loan. This is because the credit risk on the new loan has not increased significantly since the loan was initially recognised. If the Infrastructure Bank only assessed credit risk on a counterparty level, without considering whether the conclusion about changes in credit risk applies to all individual financial instruments provided to the same borrower, the objective in paragraph 76 of PBE IPSAS 41 would not be met.

Recognition and Measurement of Expected Credit Losses

IE48. The following examples illustrate the application of the recognition and measurement requirements in accordance with paragraphs 73–93 of PBE IPSAS 41, as well as the interaction with the hedge accounting requirements.

Example 8—12-Month Expected Credit Loss Measurement Using an Explicit 'Probability of Default' Approach

Scenario 1

IE49. Government A originates a single 10 year amortising loan for CU1 million. Taking into consideration the expectations for instruments with similar credit risk (using reasonable and supportable information that is available without undue cost or effort), the credit risk of the borrower, and the economic outlook for the next 12 months, Government A estimates that the loan at initial recognition has a probability of default (PD) of 0.5 per cent over the next 12 months. Government A also determines that changes in the 12-month PD are a reasonable approximation of the changes in the lifetime PD for determining whether there has been a significant increase in credit risk since initial recognition.

IE50. At the reporting date (which is before payment on the loan is due[10]), there has been no change in the 12-month PD and Government A determines that there was no significant increase in credit risk since initial recognition. Government A determines that 25 per cent of the gross carrying amount will be lost if the loan defaults (i.e., the LGD is 25 per cent).[11] Government A measures the loss allowance at an amount equal to 12-month expected credit losses using the 12-month PD of 0.5 per cent. Implicit in that calculation is the 99.5 per cent probability that there is no default. At the reporting date the loss allowance for the 12 month expected credit losses is CU1,250 (0.5% × 25% × CU1,000,000).

Scenario 2

IE51. Government B acquires a portfolio of 1,000 five year bullet loans for CU1,000 each (i.e., CU1 million in total) with an average 12-month PD of 0.5 per cent for the portfolio. Government B determines that because the loans only have significant payment obligations beyond the next 12 months, it would not be appropriate to consider changes in the 12-month PD when determining whether there have been significant increases in credit risk since initial recognition. At the reporting date Government B therefore uses changes in the lifetime PD to determine whether the credit risk of the portfolio has increased significantly since initial recognition.

IE52. Government B determines that there has not been a significant increase in credit risk since initial recognition and estimates that the portfolio has an average LGD of 25 per cent. Government B determines that it is appropriate to measure the loss allowance on a collective basis in accordance with PBE IPSAS 41. The 12-month PD remains at 0.5 per cent at the reporting date. Government B therefore measures the loss allowance on a collective basis at an amount equal to 12-month expected credit losses based on the average 0.5 per cent 12-month PD. Implicit in the calculation is the 99.5 per cent probability that there is no default. At the reporting date the loss allowance for the 12-month expected credit losses is CU1,250 (0.5% × 25% × CU1,000,000).

Example 9—12-Month Expected Credit Loss Measurement Based on a Loss Rate Approach

IE53. Government A originates 2,000 bullet loans with a total gross carrying amount of CU500,000. Government A segments its portfolio into borrower groups (Groups X and Y) on the basis of shared credit risk characteristics at initial recognition. Group X comprises 1,000 loans with a gross carrying amount per borrower of CU200, for a total gross carrying amount of CU200,000. Group Y comprises 1,000 loans with a gross carrying amount per borrower of CU300, for a total gross carrying amount of CU300,000. There are no transaction costs and the loan contracts include no options (for example, prepayment or call options), premiums or discounts, points paid, or other fees.

IE54. Government A measures expected credit losses on the basis of a loss rate approach for Groups X and Y. In order to develop its loss rates, Government A considers samples of its own historical default and loss experience for those types of loans. In addition, Government A considers forward-looking information, and updates its historical information for current economic conditions as well as reasonable and supportable forecasts of future economic conditions. Historically, for a population of 1,000 loans in each group, Group X's loss rates are 0.3 per cent, based on four defaults, and historical loss rates for Group Y are 0.15 per cent, based on two defaults.

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[10] Thus for simplicity of illustration it is assumed there is no amortisation of the loan.

[11] Because the LGD represents a percentage of the present value of the gross carrying amount, this example does not illustrate the time value of money.

	Number of clients in sample	Estimated per client gross carrying amount at default	Total estimated gross carrying amount at default	Historic per annum average defaults	Estimated total gross carrying amount at default	Present value of observed loss[(a)]	Loss rate
Group	A	B	C = A × B	D	E = B × D	F	G = F ÷ C
X	1,000	CU200	CU200,000	4	CU800	CU600	0.3%
Y	1,000	CU300	CU300,000	2	CU600	CU450	0.15%

(a) In accordance with paragraph 90(b) expected credit losses should be discounted using the effective interest rate. However, for purposes of this example, the present value of the observed loss is assumed.

IE55. At the reporting date, Government A expects an increase in defaults over the next 12 months compared to the historical rate. As a result, Government A estimates five defaults in the next 12 months for loans in Group X and three for loans in Group Y. It estimates that the present value of the observed credit loss per client will remain consistent with the historical loss per client.

IE56. On the basis of the expected life of the loans, Government A determines that the expected increase in defaults does not represent a significant increase in credit risk since initial recognition for the portfolios. On the basis of its forecasts, Government A measures the loss allowance at an amount equal to 12-month expected credit losses on the 1,000 loans in each group amounting to CU750 and CU675 respectively. This equates to a loss rate in the first year of 0.375 per cent for Group X and 0.225 per cent for Group Y.

	Number of clients in sample	Estimated per client gross carrying amount at default	Total estimated gross carrying amount at default	Expected defaults	Estimated total gross carrying amount at default	Present value of observed loss	Loss rate
Group	A	B	C = A × B	D	E = B × D	F	G = F ÷ C
X	1,000	CU200	CU200,000	5	CU1,000	CU750	0.375%
Y	1,000	CU300	CU300,000	3	CU900	CU675	0.225%

IE57. Government A uses the loss rates of 0.375 per cent and 0.225 per cent respectively to estimate 12-month expected credit losses on new loans in Group X and Group Y originated during the year and for which credit risk has not increased significantly since initial recognition.

Example 10—Revolving Credit Facilities

IE58. The Development Agency of Country A issues revolving loans to small construction companies that deliver public infrastructure. These revolving loans provide small construction companies with liquidity when cash inflows are limited. The revolving loans have a one-day notice period after which the Development Agency has the contractual right to cancel the loan (both the drawn and undrawn components). However, the Development Agency does not enforce its contractual right to cancel the revolving loans in the normal day-to-day management of the instruments and only cancels facilities when it becomes aware of an increase in credit risk and starts to monitor borrowers on an individual basis. The Development Agency therefore does not consider the contractual right to cancel the revolving loans to limit its exposure to credit losses to the contractual notice period.

IE59. For credit risk management purposes the Development Agency considers that there is only one set of contractual cash flows from borrowers to assess and does not distinguish between the drawn and undrawn balances at the reporting date. The portfolio is therefore managed and expected credit losses are measured on a facility level.

IE60. At the reporting date the outstanding balance on the revolving loan portfolio is CU60,000 and the available undrawn facility is CU40,000. The Development Agency determines the expected life of the portfolio by estimating the period over which it expects to be exposed to credit risk on the facilities at the reporting date, taking into account:

(a) The period over which it was exposed to credit risk on a similar portfolio of revolving construction loans;

(b) The length of time for related defaults to occur on similar financial instruments; and

(c) Past events that led to credit risk management actions because of an increase in credit risk on similar financial instruments, such as the reduction or removal of undrawn credit limits.

IE61. On the basis of the information listed in paragraph IE60, Development Agency determines that the expected life of the revolving loan portfolio is 30 months.

IE62. At the reporting date the Development Agency assesses the change in the credit risk on the portfolio since initial recognition and determines in accordance with paragraph 75 of PBE IPSAS 41 that the credit risk on a portion of the loan facilities representing 25 per cent of the portfolio, has increased significantly since initial recognition. The outstanding balance on these credit facilities for which lifetime expected credit losses should be recognised is CU20,000 and the available undrawn facility is CU10,000.

IE63. When measuring the expected credit losses in accordance with paragraph 93 of PBE IPSAS 41, Development Agency considers its expectations about future draw-downs over the expected life of the portfolio (i.e., 30 months) in accordance with paragraph AG195 and estimates what it expects the outstanding balance (i.e., exposure at default) on the portfolio would be if borrowers were to default. By using its credit risk models Development Agency determines that the exposure at default on the revolving loan facilities for which lifetime expected credit losses should be recognised, is CU25,000 (i.e., the drawn balance of CU20,000 plus further draw-downs of CU5,000 from the available undrawn commitment). The exposure at default of the loan facilities for which 12-month expected credit losses are recognised, is CU45,000 (i.e., the outstanding balance of CU40,000 and an additional draw-down of CU5,000 from the undrawn commitment over the next 12 months).

IE64. The exposure at default and expected life determined by the Development Agency are used to measure the lifetime expected credit losses and 12-month expected credit losses on its loan portfolio.

IE65. The Development Agency measures expected credit losses on a facility level and therefore cannot separately identify the expected credit losses on the undrawn commitment component from those on the loan component. It recognises expected credit losses for the undrawn commitment together with the loss allowance for the loan component in the statement of financial position. To the extent that the combined expected credit losses exceed the gross carrying amount of the financial asset, the expected credit losses should be presented as a provision (in accordance with PBE IPSAS 30 *Financial Instruments: Disclosures*).

Example 11—Modification of Contractual Cash Flows

IE66. Government A originates a five-year loan that requires the repayment of the outstanding contractual amount in full at maturity. Its contractual par amount is CU1,000 with an interest rate of 5 per cent payable annually. The effective interest rate is 5 per cent. At the end of the first reporting period (Period 1), Government A recognises a loss allowance at an amount equal to 12-month expected credit losses because there has not been a significant increase in credit risk since initial recognition. A loss allowance balance of CU20 is recognised.

IE67. In the subsequent reporting period (Period 2), Government A determines that the credit risk on the loan has increased significantly since initial recognition. As a result of this increase, Government A recognises lifetime expected credit losses on the loan. The loss allowance balance is CU30.

IE68. At the end of the third reporting period (Period 3), following significant financial difficulty of the borrower, Government A modifies the contractual cash flows on the loan. It extends the contractual term of the loan by one year so that the remaining term at the date of the modification is three years. The modification does not result in the derecognition of the loan by Government A.

IE69. As a result of that modification, Government A recalculates the gross carrying amount of the financial asset as the present value of the modified contractual cash flows discounted at the loan's original effective interest rate of 5 per cent. In accordance with paragraph 71 of PBE IPSAS 41, the difference between this recalculated gross carrying amount and the gross carrying amount before the modification is recognised as a modification gain or loss. Government A recognises the modification loss (calculated as CU300) against the gross carrying amount of the loan, reducing it to CU700, and a modification loss of CU300 in surplus or deficit.

IE70. Government A also remeasures the loss allowance, taking into account the modified contractual cash flows and evaluates whether the loss allowance for the loan shall continue to be measured at an amount equal to lifetime expected credit losses. Government A compares the current credit risk (taking into consideration the modified cash flows) to the credit risk (on the original unmodified cash flows) at initial recognition. Government A determines that the loan is not credit-impaired at the reporting date but that credit risk has still significantly increased compared to the credit risk at initial recognition and continues to measure the loss allowance at an amount equal to lifetime expected credit losses. The loss allowance balance for lifetime expected credit losses is CU100 at the reporting date.

Period	Beginning gross carrying amount	Impairment (loss)/gain	Modification (loss)/gain	Interest revenue	Cash flows	Ending gross carrying amount	Loss allowance	Ending amortised cost amount
	A	B	C	D Gross: A × 5%	E	F = A + C + D – E	G	H = F – G
1	CU1,000	(CU20)		CU50	CU50	CU1,000	CU20	CU980
2	CU1,000	(CU10)		CU50	CU50	CU1,000	CU30	CU970
3	CU1,000	(CU70)	(CU300)	CU50	CU50	CU700	CU100	CU600

IE71. At each subsequent reporting date, Government A evaluates whether there is a significant increase in credit risk by comparing the loan's credit risk at initial recognition (based on the original, unmodified cash flows) with the credit risk at the reporting date (based on the modified cash flows), in accordance with paragraph 84 of PBE IPSAS 41.

IE72. Two reporting periods after the loan modification (Period 5), the borrower has outperformed its business plan significantly compared to the expectations at the modification date. In addition, the outlook for the business is more positive than previously envisaged. An assessment of all reasonable and supportable information that is available without undue cost or effort indicates that the overall credit risk on the loan has decreased and that the risk of a default occurring over the expected life of the loan has decreased, so Government A adjusts the borrower's internal credit rating at the end of the reporting period.

IE73. Given the positive overall development, Government A re-assesses the situation and concludes that the credit risk of the loan has decreased and there is no longer a significant increase in credit risk since initial recognition. As a result, Government A once again measures the loss allowance at an amount equal to 12-month expected credit losses.

Example 12—Provision Matrix

IE74. Municipality M provides water delivery services for households within its jurisdiction. Households are invoiced on a monthly basis based on the water consumed during the period. This represents a portfolio of trade receivables of CU30 million in 20X1 for Municipality M. The portfolio consists of a large number of households with small balances outstanding. The trade receivables are categorised by common risk characteristics that are representative of the households' abilities to pay all amounts due in accordance with the contractual terms. The trade receivables do not have a significant financing component. In accordance with paragraph 87 of PBE IPSAS 41 the loss allowance for such trade receivables is always measured at an amount equal to lifetime time expected credit losses.

IE75. To determine the expected credit losses for the portfolio, Municipality M uses a provision matrix. The provision matrix is based on its historical observed default rates over the expected life of the trade receivables and is adjusted for forward-looking estimates. At every reporting date the historical observed default rates are updated and changes in the forward-looking estimates are analysed. In this case it is forecast that economic conditions will deteriorate over the next year.

IE76. On that basis, Municipality M estimates the following provision matrix:

	Current	1–30 days past due	31–60 days past due	61–90 days past due	More than 90 days past due
Default rate	0.3%	1.6%	3.6%	6.6%	10.6%

IE77. The trade receivables from the large number of households amount to CU30 million and are measured using the provision matrix.

	Gross carrying amount	Lifetime expected credit loss allowance (Gross carrying amount x lifetime expected credit loss rate)
Current	CU15,000,000	CU45,000
1–30 days past due	CU7,500,000	CU120,000
31–60 days past due	CU4,000,000	CU144,000
61–90 days past due	CU2,500,000	CU165,000
More than 90 days past due	CU1,000,000	CU106,000
	CU30,000,000	**CU580,000**

Example 13—Debt Instrument Measured at Fair Value Through other Comprehensive Revenue and Expense

IE78. Public Investment Fund A purchases a debt instrument with a fair value of CU1,000 on December 15, 20X0 and measures the debt instrument at fair value through other comprehensive revenue and expense. The instrument has an interest rate of 5 per cent over the contractual term of 10 years, and has a 5 per cent effective interest rate. At initial recognition the entity determines that the asset is not purchased or originated credit-impaired.

	Debit	Credit
Financial asset—Fair Value Through Other Comprehensive Revenue and Expense	CU1,000	
Cash		CU1,000
(To recognise the debt instrument measured at its fair value)		

IE79. On December 31, 20X0 (the reporting date), the fair value of the debt instrument has decreased to CU950 as a result of changes in market interest rates. The entity determines that there has not been a significant increase in credit risk since initial recognition and that expected credit losses should be measured at an amount equal to 12-month expected credit losses, which amounts to CU30. For simplicity, journal entries for the receipt of interest revenue are not provided.

	Debit	Credit
Impairment loss (surplus or deficit)	CU30	
Other comprehensive revenue or expense[(a)]	CU20	
Financial asset—Fair Value Through Other Comprehensive Revenue and Expense		CU50
(To recognise 12-month expected credit losses and other fair value changes on the debt instrument)		
(a) The cumulative loss in other comprehensive revenue and expense at the reporting date was CU20. That amount consists of the total fair value change of CU50 (i.e., CU1,000 – CU950) offset by the change in the accumulated impairment amount representing 12-month expected credit losses that was recognised (CU30).		

IE80. Disclosure would be provided about the accumulated impairment amount of CU30.

IE81. On January 1, 20X1, the entity decides to sell the debt instrument for CU950, which is its fair value at that date.

	Debit	Credit
Cash	CU950	
Financial asset—Fair Value Through Other Comprehensive Revenue and Expense		CU950
Loss (surplus or deficit)	CU20	
Other comprehensive revenue and expense		CU20
(To derecognise the fair value through other comprehensive revenue and expense asset and recycle amounts accumulated in other comprehensive revenue and expense to surplus or deficit)		

Example 14—Interaction Between the Fair Value Through Other Comprehensive Revenue and Expense Measurement Category and Foreign Currency Denomination, Fair Value Hedge Accounting and Impairment

IE82. This example illustrates the accounting relating to a debt instrument denominated in a foreign currency, measured at fair value through other comprehensive revenue and expense and designated in a fair value hedge accounting relationship. The example illustrates the interaction with accounting for impairment.

IE83. An entity purchases a debt instrument (a bond) denominated in a foreign currency (FC) for its fair value of FC100,000 on January 1, 20X0 and classifies the bond as measured at fair value through other comprehensive revenue and expense. The bond has five years remaining to maturity and a fixed coupon of 5 per cent over its contractual life on the contractual par amount of FC100,000. On initial recognition the bond has a 5 per cent effective interest rate. The entity's functional currency is its local currency (LC). The exchange rate is FC1 to LC1 on January 1, 20X0. At initial recognition the entity determines that the bond is not purchased or originated credit-impaired. In addition, as at January 1, 20X0 the 12-month expected credit losses are determined to be FC1,200. Its amortised cost in FC as at January 1, 20X0 is equal to its gross carrying amount of FC100,000 less the 12-month expected credit losses (FC100,000—FC1,200).

IE84. The entity has the following risk exposures:

(a) Fair value interest rate risk in FC: the exposure that arises as a result of purchasing a fixed interest rate instrument; and

(b) Foreign exchange risk: the exposure to changes in foreign exchange rates measured in LC.

IE85. The entity hedges its risk exposures using the following risk management strategy:

(a) For fixed interest rate risk (in FC) the entity decides to link its interest receipts in FC to current variable interest rates in FC. Consequently, the entity uses interest rate swaps denominated in FC under which it pays fixed interest and receives variable interest in FC; and

(b) For foreign exchange risk the entity decides not to hedge against any variability in LC arising from changes in foreign exchange rates.

IE86. The entity designates the following hedge relationship:[12] a fair value hedge of the bond in FC as the hedged item with changes in benchmark interest rate risk in FC as the hedged risk. The entity enters into an on-market swap that pays fixed and receives variable interest on the same day and designates the swap as the hedging instrument. The tenor of the swap matches that of the hedged item (i.e., five years).

IE87. For simplicity, in this example it is assumed that no hedge ineffectiveness arises in the hedge accounting relationship. This is because of the assumptions made in order to better focus on illustrating the accounting mechanics in a situation that entails measurement at fair value through other comprehensive revenue and expense of a foreign currency financial instrument that is designated in a fair value hedge relationship, and also to focus on the recognition of impairment gains or losses on such an instrument.

[12] The cumulative loss in other comprehensive revenue and expense at the reporting date was CU20. That amount consists of the total fair value change of CU50 (i.e., CU1,000 – CU950) offset by the change in the accumulated impairment amount representing 12-month expected credit losses that was recognised (CU30).This example assumes that all qualifying criteria for hedge accounting are met (see paragraph 129 of PBE IPSAS 41). The following description of the designation is solely for the purpose of understanding this example (i.e., it is not an example of the complete formal documentation required in accordance with paragraph 129 of PBE IPSAS 41).

IE88. The entity makes the following journal entries to recognise the bond and the swap on January 1, 20X0:

	Debit LC	**Credit LC**
Financial asset—Fair Value Through Other Comprehensive Revenue and Expense	100,000	
Cash		100,000
(To recognise the bond at its fair value)		
Impairment loss (surplus or deficit)	1,200	
Other comprehensive revenue and expense		1,200
(To recognise the 12-month expected credit losses)[(a)]		
Swap	–	
Cash		–
(To recognise the swap at its fair value)		
(a) In case of items measured in the functional currency of an entity the journal entry recognising expected credit losses will usually be made at the reporting date.		

IE89. As of December 31, 20X0 (the reporting date), the fair value of the bond decreased from FC100,000 to FC96,370 because of an increase in market interest rates. The fair value of the swap increased to FC1,837. In addition, as at December 31, 20X0 the entity determines that there has been no change to the credit risk on the bond since initial recognition and continues to carry a loss allowance for 12-month expected credit losses at FC1,200.[13] As at December 31, 20X0, the exchange rate is FC1 to LC1.4. This is reflected in the following table:

	January 1, 20X0	**December 31, 20X0**
Bond		
Fair value (FC)	100,000	96,370
Fair value (LC)	100,000	134,918
Amortised cost (FC)	98,800	98,800
Amortised cost (LC)	98,800	138,320
Interest rate swap		
Interest rate swap (FC)	–	1,837
Interest rate swap (LC)	–	2,572
Impairment – loss allowance		
Loss allowance (FC)	1,200	1,200
Loss allowance (LC)	1,200	1,680
FX rate (FC:LC)	1:1	1:1.4

IE90. The bond is a monetary asset. Consequently, the entity recognises the changes arising from movements in foreign exchange rates in surplus or deficit in accordance with paragraphs 27(a) and 32 of PBE IPSAS 4 *The Effects of Changes in Foreign Exchange Rates* and recognises other changes in accordance with PBE IPSAS 41. For the purposes of applying paragraph 32 of PBE IPSAS 4 the asset is treated as an asset measured at amortised cost in the foreign currency.

IE91. As shown in the table, on December 31, 20X0 the fair value of the bond is LC134,918 (FC96,370 × 1.4) and its amortised cost is LC138,320 (FC(100,000–1,200) × 1.4).

IE92. The gain recognised in surplus or deficit that is due to the changes in foreign exchange rates is LC39,520 (LC138,320 – LC98,800), i.e., the change in the amortised cost of the bond during 20X0 in LC. The change in the fair value of the bond in LC, which amounts to LC34,918, is recognised as an adjustment to the carrying amount. The difference between the fair value of the bond and its amortised cost in LC is LC3,402 (LC134,918 – LC138,320). However, the change in the cumulative gain or loss recognised in other comprehensive revenue and expense during 20X0 as a reduction is LC 4,602 (LC3,402 + LC1,200).

13 For the purposes of simplicity the example ignores the impact of discounting when computing expected credit losses.

IE93. A gain of LC2,572 (FC1,837 × 1.4) on the swap is recognised in surplus or deficit and, because it is assumed that there is no hedge ineffectiveness, an equivalent amount is recycled from other comprehensive revenue and expense in the same period. For simplicity, journal entries for the recognition of interest revenue are not provided. It is assumed that interest accrued is received in the period.

IE94. The entity makes the following journal entries on December 31, 20X0:

	Debit LC	**Credit LC**
Financial asset—Fair Value Through Other Comprehensive Revenue and Expense	34,918	
Other comprehensive revenue and expense	4,602	
Surplus or deficit		39,520
(To recognise the foreign exchange gain on the bond, the adjustment to its carrying amount measured at fair value in LC and the movement in the accumulated impairment amount due to changes in foreign exchange rates)		
Swap	2,572	
Surplus or deficit		2,572
(To remeasure the swap at fair value)		
Surplus or deficit	2,572	
Other comprehensive revenue and expense		2,572
(To recognise in surplus or deficit the change in fair value of the bond due to a change in the hedged risk)		

IE95. In accordance with paragraph 20A of PBE IPSAS 30, the loss allowance for financial assets measured at fair value through other comprehensive revenue and expense is not presented separately as a reduction of the carrying amount of the financial asset. However, disclosure would be provided about the accumulated impairment amount recognised in other comprehensive revenue and expense.

IE96. As at December 31, 20X1 (the reporting date), the fair value of the bond decreased to FC87,114 because of an increase in market interest rates and an increase in the credit risk of the bond. The fair value of the swap increased by FC255 to FC2,092. In addition, as at December 31, 20X1 the entity determines that there has been a significant increase in credit risk on the bond since initial recognition, so a loss allowance at an amount equal to lifetime expected credit losses is recognised.[14] The estimate of lifetime expected credit losses as at December 31, 20X1 is FC9,700. As at December 31, 20X1, the exchange rate is FC1 to LC1.25. This is reflected in the following table:

	December 31, 20X0	**December 31, 20X1**
Bond		
Fair value (FC)	96,370	87,114
Fair value (LC)	134,918	108,893
Amortised cost (FC)	98,800	90,300
Amortised cost (LC)	138,320	112,875
Interest rate swap		
Interest rate swap (FC)	1,837	2,092
Interest rate swap (LC)	2,572	2,615
Impairment – loss allowance		
Loss allowance (FC)	1,200	9,700
Loss allowance (LC)	1,680	12,125
FX rate (FC:LC)	1:1.4	1:1.25

IE97. As shown in the table, as at December 31, 20X1 the fair value of the bond is LC108,893 (FC87,114 × 1.25) and its amortised cost is LC112,875 (FC(100,000 – 9,700) × 1.25).

IE98. The lifetime expected credit losses on the bond are measured as FC9,700 as of December 31, 20X1. Thus the impairment loss recognised in ~~profit or loss~~surplus or deficit in LC is LC10,625 (FC(9,700 – 1,200) x 1.25).

[14] For simplicity this example assumes that credit risk does not dominate the fair value hedge relationship.

IE99. The loss recognised in surplus or deficit because of the changes in foreign exchange rates is LC14,820 (LC112,875 – LC138,320 + LC10,625), which is the change in the gross carrying amount of the bond on the basis of amortised cost during 20X1 in LC, adjusted for the impairment loss. The difference between the fair value of the bond and its amortised cost in the functional currency of the entity on December 31, 20X1 is LC3,982 (LC108,893 – LC112,875). However, the change in the cumulative gain or loss recognised in other comprehensive revenue and expense during 20X1 as a reduction in other comprehensive revenue and expense is LC11,205 (LC3,982 – LC3,402 + LC10,625).

IE100. A gain of LC43 (LC2,615 – LC2,572) on the swap is recognised in surplus or deficit and, because it is assumed that there is no hedge ineffectiveness, an equivalent amount is recycled from other comprehensive revenue and expense in the same period.

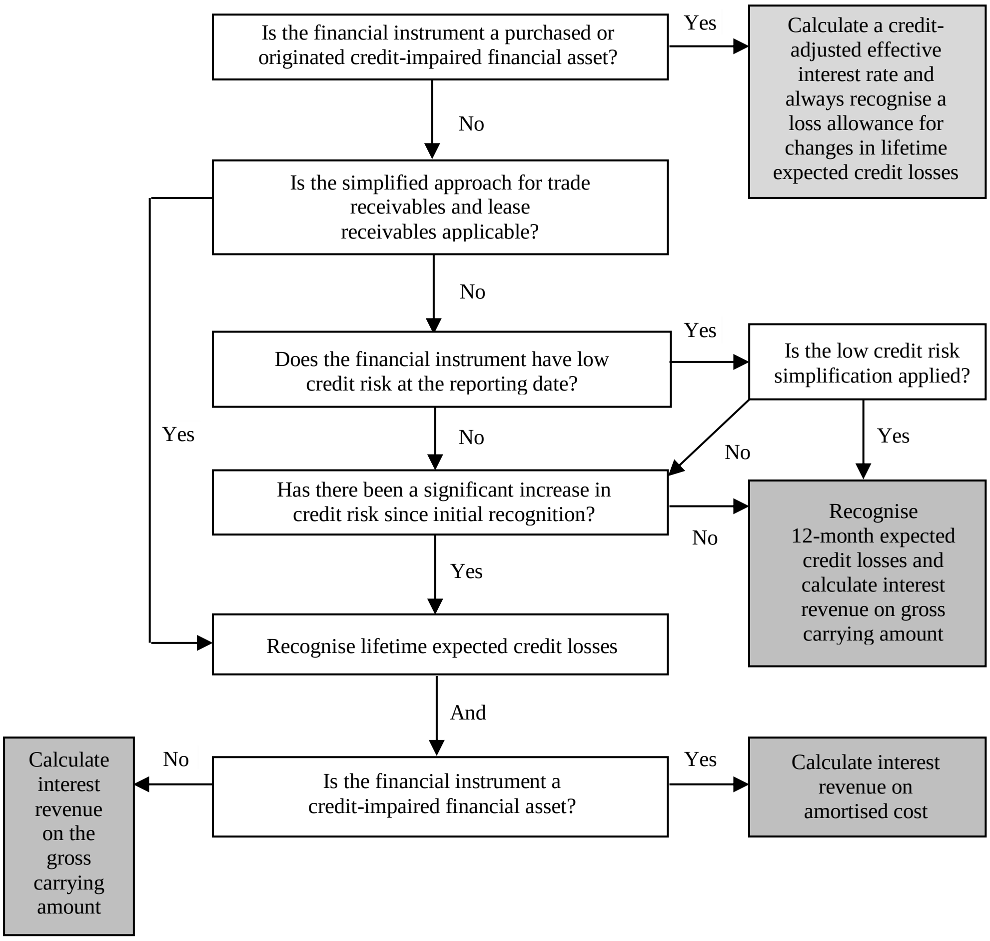
IE101. The entity makes the following journal entries on December 31, 20X1:

	Debit LC	**Credit LC**
Financial asset—Fair Value Through Other Comprehensive Revenue and Expense		26,025
Other comprehensive revenue and expense	11,205	
Surplus or deficit	14,820	
(To recognise the foreign exchange gain on the bond, the adjustment to its carrying amount measured at fair value in LC and the movement in the accumulated impairment amount due to changes in foreign exchange rates)		
Swap	43	
Surplus or deficit		43
(To remeasure the swap at fair value)		
Surplus or deficit	43	
Other comprehensive revenue and expense		43
(To recognise in surplus or deficit the change in fair value of the bond due to a change in the hedged risk)		
Surplus or deficit (impairment loss)	10,625	
Other comprehensive revenue and expense (accumulated impairment amount)		10,625
(To recognise lifetime expected credit losses)		

IE102. On January 1, 20X2, the entity decides to sell the bond for FC 87,114, which is its fair value at that date and also closes out the swap at fair value. The foreign exchange rate is the same as at December 31, 20X1. The journal entries to derecognise the bond and reclassify the gains and losses that have accumulated in other comprehensive revenue and expense would be as follows:

	Debit LC	**Credit LC**
Cash	108,893	
Financial asset—Fair Value Through Other Comprehensive Revenue and Expense		108,893
Loss on sale (surplus or deficit)	1,367[(a)]	
Other comprehensive revenue and expense		1,367
(To derecognise the bond)		
Swap		2,615
Cash	2,615	
(To close out the swap)		
(a) This amount consists of the changes in fair value of the bond, the accumulated impairment amount and the changes in foreign exchange rates recognised in other comprehensive revenue and expense (LC2,572 + LC1,200 + LC43 + LC10,625 – LC4,602 – LC11,205 = -LC1,367, which is recycled as a loss in surplus or deficit).		

Application of the Impairment Requirements on a Reporting Date



Reclassification of Financial Assets (paragraphs 94–100)

IE103. This example illustrates the accounting requirements for the reclassification of financial assets between measurement categories in accordance with 94–100 of PBE IPSAS 41. The example illustrates the interaction with the impairment requirements in paragraphs 73–93 of PBE IPSAS 41.

Example 15—Reclassification of Financial Assets

IE104. An entity purchases a portfolio of bonds for its fair value (gross carrying amount) of CU500,000.

IE105. The entity changes the management model for managing the bonds in accordance with paragraph 54 of PBE IPSAS 41. The fair value of the portfolio of bonds at the reclassification date is CU490,000.

IE106. If the portfolio was measured at amortised cost or at fair value through other comprehensive revenue and expense immediately prior to reclassification, the loss allowance recognised at the date of reclassification would be CU6,000 (reflecting a significant increase in credit risk since initial recognition and thus the measurement of lifetime expected credit losses).

IE107. The 12-month expected credit losses at the reclassification date are CU4,000.

IE108. For simplicity, journal entries for the recognition of interest revenue are not provided.

Scenario 1: Reclassification Out of the Amortised Cost Measurement Category and into the Fair Value Through Surplus or Deficit Measurement Category

IE109. Department of Treasury A reclassifies the portfolio of bonds out of the amortised cost measurement category and into the fair value through surplus or deficit measurement category. At the reclassification date, the portfolio of bonds is measured at fair value. Any gain or loss arising from a difference between the previous amortised cost amount of the portfolio of bonds and the fair value of the portfolio of bonds is recognised in surplus or deficit on reclassification.

	Debit	Credit
Bonds (Fair Value Through Surplus or Deficit assets)	CU490,000	
Bonds (gross carrying amount of the amortised cost assets)		CU500,000
Loss allowance	CU6,000	
Reclassification loss (surplus or deficit)	CU4,000	
(To recognise the reclassification of bonds from amortised cost to fair value through surplus or deficit and to derecognise the loss allowance.)		

Scenario 2: Reclassification Out of the Fair Value Through Surplus or Deficit Measurement Category and into the Amortised Cost Measurement Category

IE110. Department of Treasury A reclassifies the portfolio of bonds out of the fair value through surplus or deficit measurement category and into the amortised cost measurement category. At the reclassification date, the fair value of the portfolio of bonds becomes the new gross carrying amount and the effective interest rate is determined based on that gross carrying amount. The impairment requirements apply to the bond from the reclassification date. For the purposes of recognising expected credit losses, the credit risk of the portfolio of bonds at the reclassification date becomes the credit risk against which future changes in credit risk shall be compared.

	Debit	Credit
Bonds (gross carrying amount of the amortised cost assets)	CU490,000	
Bonds (Fair Value Through Surplus or Deficit assets)		CU490,000
Impairment loss (surplus or deficit)	CU4,000	
Loss allowance		CU4,000
(To recognise reclassification of bonds from fair value through surplus or deficit to amortised cost including commencing accounting for impairment.)		

Scenario 3: Reclassification Out of the Amortised Cost Measurement Category and into the Fair Value Through Other Comprehensive Revenue and Expense Measurement Category

IE111. Department of Treasury A reclassifies the portfolio of bonds out of the amortised cost measurement category and into the fair value through other comprehensive revenue and expense measurement category. At the reclassification date, the portfolio of bonds is measured at fair value. Any gain or loss arising from a difference between the previous amortised cost amount of the portfolio of bonds and the fair value of the portfolio of bonds is recognised in other comprehensive revenue and expense. The effective interest rate and the measurement of expected credit losses are not adjusted as a result of the reclassification. The credit risk at initial recognition continues to be used to assess changes in credit risk. From the reclassification date the loss allowance ceases to be recognised as an adjustment to the gross carrying amount of the bond and is recognised as an accumulated impairment amount, which would be disclosed.

	Debit	Credit
Bonds (Fair Value Through Other Comprehensive Revenue and Expense assets)	CU490,000	
Bonds (gross carrying amount of amortised cost assets)		CU500,000
Loss allowance	CU6,000	
Other comprehensive revenue and expense[(a)]	CU4,000	
(To recognise the reclassification from amortised cost to fair value through other comprehensive revenue and expense. The measurement of expected credit losses is however unchanged.) (a) For simplicity, the amount related to impairment is not shown separately. If it had been, this journal entry (i.e., DR CU4,000) would be split into the following two entries: DR Other comprehensive revenue and expense CU10,000 (fair value changes) and CR other comprehensive revenue and expense CU6,000 (accumulated impairment amount).		

Scenario 4: Reclassification Out of the Fair Value Through Other Comprehensive Revenue and Expense Measurement Category and into the Amortised Cost Measurement Category

IE112. Department of Treasury A reclassifies the portfolio of bonds out of the fair value through other comprehensive revenue and expense measurement category and into the amortised cost measurement category. The portfolio of bonds is reclassified at fair value. However, at the reclassification date, the cumulative gain or loss previously recognised in other comprehensive revenue and expense is removed from equity and adjusted against the fair value of the portfolio of bonds. As a result, the portfolio of bonds is measured at the reclassification date as if it had always been measured at amortised cost. The effective interest rate and the measurement of expected credit losses are not adjusted as a result of the reclassification. The credit risk at initial recognition continues to be used to assess changes in the credit risk on the bonds. The loss allowance is recognised as an adjustment to the gross carrying amount of the bond (to reflect the amortised cost amount) from the reclassification date.

	Debit	Credit
Bonds (gross carrying value of the amortised cost assets)	CU490,000	
Bonds (Fair Value Through Other Comprehensive Revenue and Expense assets)		CU490,000
Bonds (gross carrying value of the amortised cost assets)	CU10,000	
Loss allowance		CU6,000
Other comprehensive revenue and expense[(a)]		CU4,000
(To recognise the reclassification from fair value through other comprehensive revenue and expense to amortised cost including the recognition of the loss allowance deducted to determine the amortised cost amount. The measurement of expected credit losses is however unchanged.)		
(a) The cumulative loss in other comprehensive revenue and expense at the reclassification date was CU4,000. That amount consists of the total fair value change of CU10,000 (i.e., CU500,000 – 490,000) offset by the accumulated impairment amount recognised (CU6,000) while the assets were measured at fair value through other comprehensive revenue and expense.		

Scenario 5: Reclassification Out of the Fair Value Through Surplus or Deficit Measurement Category and into the Fair Value Through Other Comprehensive Revenue and Expense Measurement Category

IE113. Department of Treasury A reclassifies the portfolio of bonds out of the fair value through surplus or deficit measurement category and into the fair value through other comprehensive revenue and expense measurement category. The portfolio of bonds continues to be measured at fair value. However, for the purposes of applying the effective interest method, the fair value of the portfolio of bonds at the reclassification date becomes the new gross carrying amount and the effective interest rate is determined based on that new gross carrying amount. The impairment requirements apply from the reclassification date. For the purposes of recognising expected credit losses, the credit risk of the portfolio of bonds at the reclassification date becomes the credit risk against which future changes in credit risk shall be compared.

	Debit	Credit
Bonds (Fair Value Through Other Comprehensive Revenue and Expense assets)	CU490,000	
Bonds (Fair Value Through Surplus or Deficit assets)		CU490,000
Impairment loss (surplus or deficit)	CU4,000	
Other comprehensive revenue and expense [(a)]		CU4,000
(To recognise the reclassification of bonds from fair value through surplus or deficit to fair value through other comprehensive revenue and expense including commencing accounting for impairment. The other comprehensive revenue and expense amount reflects the loss allowance at the date of reclassification (an accumulated impairment amount relevant for disclosure purposes) of CU4,000.)		

Scenario 6: Reclassification Out of the Fair Value Through Other Comprehensive Revenue and Expense Measurement Category and into the Fair Value Through Surplus or Deficit Measurement Category

IE114. Department of Treasury A reclassifies the portfolio of bonds out of the fair value through other comprehensive revenue and expense measurement category and into the fair value through surplus or deficit measurement category. The portfolio of bonds continues to be measured at fair value. However, the cumulative gain or loss previously recognised in other comprehensive revenue and expense is reclassified from net assets/equity to surplus or deficit as a reclassification adjustment (see PBE IPSAS 1 *Presentation of Financial Reports*).

	Debit	Credit
Bonds (Fair Value Through Surplus or Deficit assets)	CU490,000	
Bonds (Fair Value Through Other Comprehensive Revenue and Expense assets)		CU490,000
Reclassification loss (surplus or deficit)	CU4,000	
Other comprehensive revenue and expense		CU4,000
(To recognise the reclassification of bonds from fair value through other comprehensive revenue and expense to fair value through surplus or deficit.) (a) The cumulative loss in other comprehensive revenue and expense at the reclassification date was CU4,000. That amount consists of the total fair value change of CU10,000 (i.e., CU500,000 – 490,000) offset by the loss allowance that was recognised (CU6,000) while the assets were measured at fair value through other comprehensive revenue and expense.		

Hedge Accounting for Aggregated Exposures

IE115. The following examples illustrate the mechanics of hedge accounting for aggregated exposures.

Example 16—Combined Commodity Price Risk and Foreign Currency Risk Hedge (Cash Flow Hedge/Cash Flow Hedge Combination)

Fact Pattern

IE116. Municipality A wants to hedge a highly probable forecast electricity purchase (which is expected to occur at the end of Period 5). Municipality A's functional currency is its Local Currency (LC). Electricity is traded in Foreign Currency (FC). Municipality A has the following risk exposures:

(a) Commodity price risk: the variability in cash flows for the purchase price, which results from fluctuations of the spot price of electricity in FC; and

(b) Foreign currency (FX) risk: the variability in cash flows that result from fluctuations of the spot exchange rate between LC and FC.

IE117. Municipality A hedges its risk exposures using the following risk management strategy:

(a) Municipality A uses benchmark commodity forward contracts, which are denominated in FC, to hedge its electricity purchases four periods before delivery. The electricity price that Municipality A actually pays for its purchase is different from the benchmark price because of differences in the type of electricity, the location and delivery arrangement.[15] This gives rise to the risk of changes in the relationship between the two electricity prices (sometimes referred to as 'basis risk'), which affects the effectiveness of the hedging relationship. Municipality A does not hedge this risk because it is not considered economical under cost/benefit considerations.

(b) Municipality A also hedges its FX risk. However, the FX risk is hedged over a different horizon—only three periods before delivery. Municipality A considers the FX exposure from the variable payments for the electricity purchase in FC and the gain or loss on the commodity forward contract in FC as one aggregated FX exposure. Hence, Municipality A uses one single FX forward contract to hedge the FX cash flows from a forecast electricity purchase and the related commodity forward contract.

[15] For the purpose of this example it is assumed that the hedged risk is not designated based on a benchmark electricity price risk component. Consequently, the entire electricity price risk is hedged.

IE118. The following table sets out the parameters used for Example 16 (the 'basis spread' is the differential, expressed as a percentage, between the price of the electricity that Municipality A actually buys and the price for the benchmark electricity):

Example 16—Parameters **Period**	**1**	**2**	**3**	**4**	**5**
Interest rates for remaining maturity [FC]	0.26%	0.21%	0.16%	0.06%	0.00%
Interest rates for remaining maturity [LC]	1.12%	0.82%	0.46%	0.26%	0.00%
Forward price [FC/MWh]	1.25	1.01	1.43	1.22	2.15
Basis spread	-5.00%	-5.50%	-6.00%	-3.40%	-7.00%
FX rate (spot) [FC/LC]	1.3800	1.3300	1.4100	1.4600	1.4300

Accounting Mechanics

IE119. Entity A designates as cash flow hedges the following two hedging relationships:[16]

(a) A commodity price risk hedging relationship between the electricity price related variability in cash flows attributable to the forecast electricity purchase in FC as the hedged item and a commodity forward contract denominated in FC as the hedging instrument (the 'first level relationship'). This hedging relationship is designated at the end of Period 1 with a term to the end of Period 5. Because of the basis spread between the price of the electricity that Municipality A actually buys and the price for the benchmark electricity, Municipality A designates a volume of 112,500 MWh of electricity as the hedging instrument and a volume of 118,421 MWh as the hedged item.[17]

(b) An FX risk hedging relationship between the aggregated exposure as the hedged item and an FX forward contract as the hedging instrument (the 'second level relationship'). This hedging relationship is designated at the end of Period 2 with a term to the end of Period 5. The aggregated exposure that is designated as the hedged item represents the FX risk that is the effect of exchange rate changes, compared to the forward FX rate at the end of Period 2 (i.e., the time of designation of the FX risk hedging relationship), on the combined FX cash flows in FC of the two items designated in the commodity price risk hedging relationship, which are the forecast electricity purchase and the commodity forward contract. Municipality A's long-term view of the basis spread between the price of the electricity that it actually buys and the price for the benchmark electricity has not changed from the end of Period 1. Consequently, the actual volume of hedging instrument that Municipality A enters into (the nominal amount of the FX forward contract of FC140,625) reflects the cash flow exposure associated with a basis spread that had remained at -5 per cent. However, Municipality A's actual aggregated exposure is affected by changes in the basis spread. Because the basis spread has moved from -5 per cent to -5.5 per cent during Period 2, Municipality A's actual aggregated exposure at the end of Period 2 is FC140,027.

[16] This example assumes that all qualifying criteria for hedge accounting are met (see paragraph 129 of PBE IPSAS 41). The following description of the designation is solely for the purpose of understanding this example (i.e., it is not an example of the complete formal documentation required in accordance with paragraph 129(b) of PBE IPSAS 41).

[17] In this example, the current basis spread at the time of designation is coincidentally the same as Municipality A's long-term view of the basis spread (-5 per cent) that determines the volume of electricity purchases that it actually hedges. Also, this example assumes that Municipality A designates the hedging instrument in its entirety and designates as much of its highly probable forecast purchases as it regards as hedged. That results in a hedge ratio of 1/(100%-5%). Other entities might follow different approaches when determining what volume of their exposure they actually hedge, which can result in a different hedge ratio and also designating less than a hedging instrument in its entirety (see paragraph 129 of PBE IPSAS 41).

IE120. The following table sets out the fair values of the derivatives, the changes in the value of the hedged items and the calculation of the cash flow hedge reserves and hedge ineffectiveness:[18]

Example 16—Calculations		**Period**	**1**	**2**	**3**	**4**	**5**
Commodity Price Risk Hedging Relationship (First Level Relationship)							
Forward Purchase Contract for Electricity							
Volume (MWh)	112,500						
Forward price [FC/MWh]	1.25	Price (fwd) [FC/MWh]	1.25	1.01	1.43	1.22	2.15
		Fair value [FC]	0	(26,943)	20,219	(3,373)	101,250
		Fair value [LC]	0	(20,258)	14,339	(2,310)	70,804
		Change in fair value [LC]		(20,258)	34,598	(16,650)	73,114
Hedged Forecast Electricity Purchase							
Hedge ratio	105.26%	Basis spread	-5.00%	-5.50%	-6.00%	-3.40%	-7.00%
Hedged volume	118,421	Price (fwd) [FC/MWh]	1.19	0.95	1.34	1.18	2.00
Implied forward price	1.1875	Present value [FC]	0	27,540	(18,528)	1,063	(96,158)
		Present value [LC]	0	20,707	(13,140)	728	(67,243)
		Change in present value [LC]		20,707	(33,847)	13,868	(67,971)
Accounting			*LC*	*LC*	*LC*	*LC*	*LC*
Derivative			0	(20,258)	14,339	(2,310)	70,804
Cash flow hedge reserve			0	(20,258)	13,140	(728)	67,243
Change in cash flow hedge reserve				(20,258)	33,399	(13,868)	67,971
Surplus or deficit				0	1,199	(2,781)	5,143
Accumulated surplus or deficit			0	0	1,199	(1,582)	3,561
FX Risk Hedging Relationship (Second Level Relationship)							
FX rate [FC/LC]		Spot	1.3800	1.3300	1.4100	1.4600	1.4300
		Forward	1.3683	1.3220	1.4058	1.4571	1.4300
FX forward contract (Buy FC/Sell LC)							
Volume [FC]	140,625						
Forward rate (in P_2)	1.3220	Fair value [LC]		0	(6,313)	(9,840)	(8,035)
		Change in fair value [LC]			(6,313)	(3,528)	1,805
Hedged FX risk							
Aggregated FX exposure		Hedged volume [FC]		140,027	138,932	142,937	135,533
		Present value [LC]		0	6,237	10,002	7,744
		Change in present value [LC]			6,237	3,765	(2,258)
Accounting				*LC*	*LC*	*LC*	*LC*
Derivative				0	(6,313)	(9,840)	(8,035)
Cash flow hedge reserve				0	(6,237)	(9,840)	(7,744)
Change in cash flow hedge reserve					(6,237)	(3,604)	2,096
Surplus or deficit					(76)	76	(291)
Accumulated surplus or deficit				0	(76)	0	(291)

IE121. The commodity price risk hedging relationship is a cash flow hedge of a highly probable forecast transaction that starts at the end of Period 1 and remains in place when the FX risk hedging relationship starts at the end of Period 2, i.e., the first level relationship continues as a separate hedging relationship.

[18] In the following table for the calculations all amounts (including the calculations for accounting purposes of amounts for assets, liabilities, net assets/equity and surplus or deficit) are in the format of positive (plus) and negative (minus) numbers (e.g., a surplus or deficit amount that is a negative number is a loss).

IE122. The volume of the aggregated FX exposure (in FC), which is the hedged volume of the FX risk hedging relationship, is the total of:[19]

(a) The hedged electricity purchase volume multiplied by the current forward price (this represents the expected spot price of the actual electricity purchase); and

(b) The volume of the hedging instrument (designated nominal amount) multiplied by the difference between the contractual forward rate and the current forward rate (this represents the expected price differential from benchmark electricity price movements in FC that Municipality A will receive or pay under the commodity forward contract).

IE123. The present value (in LC) of the hedged item of the FX risk hedging relationship (i.e., the aggregated exposure) is calculated as the hedged volume (in FC) multiplied by the difference between the forward FX rate at the measurement date and the forward FX rate at the designation date of the hedging relationship (i.e., the end of Period 2).[20]

IE124. Using the present value of the hedged item and the fair value of the hedging instrument, the cash flow hedge reserve and the hedge ineffectiveness are then determined (see paragraph 140 of PBE IPSAS 41).

IE125. The following table shows the effect on Municipality A's statement of comprehensive revenue and expense and its statement of financial position (for the sake of transparency the line items[21] are disaggregated on the face of the statements by the two hedging relationships, i.e., for the commodity price risk hedging relationship and the FX risk hedging relationship):

Example 16—Overview of Effect on Statements of Comprehensive Revenue and Expense and Financial Position
[All amounts in LC]

Period	**1**	**2**	**3**	**4**	**5**
Statement of comprehensive revenue and expense					
Hedge ineffectiveness					
Commodity hedge		0	(1,199)	2,781	(5,143)
FX hedge		0	76	(76)	291
Surplus or deficit	0	0	(1,123)	2,705	(4,852)
Other comprehensive revenue and expense					
Commodity hedge		20,258	(33,399)	13,868	(67,971)
FX hedge		0	6,237	3,604	(2,096)
Total other comprehensive revenue and expense	0	20,258	(27,162)	17,472	(70,067)
Comprehensive revenue and expense	0	20,258	(28,285)	20,177	(74,920)
Statement of financial position					
Commodity forward	0	(20,258)	14,339	(2,310)	70,804
FX forward		0	(6,313)	(9,840)	(8,035)
Total net assets	0	(20,258)	8,027	(12,150)	62,769
Net assets/equity					
Accumulated other comprehensive revenue and expense					
Commodity hedge	0	20,258	(13,140)	728	(67,243)
FX hedge		0	6,237	9,840	7,744
	0	20,258	(6,904)	10,568	(59,499)

[19] For example, at the end of Period 3 the aggregated FX exposure is determined as: 118,421 MWh × 1.34 FC/MWh = FC159,182 for the expected price of the actual electricity purchase and 112,500 MWh × (1.25 [FC/MWh] – 1.43 [FC/MWh]) = FC(20,250) for the expected price differential under the commodity forward contract, which gives a total of FC138,932—the volume of the aggregated FX exposure at the end of Period 3.

[20] For example, at the end of Period 3 the present value of the hedged item is determined as the volume of the aggregated exposure at the end of Period 3 (FC138,932) multiplied by the difference between the forward FX rate at the end of Period 3 (1/1.4058) and the forward FX rate and the time of designation (i.e., the end of Period 2: 1/1.3220) and then discounted using the interest rate (in LC) at the end of Period 3 with a term of 2 periods (i.e., until the end of Period 5 – 0.46%). The calculation is: FC138,932 × (1/(1.4058[FC/LC]) – 1/(1.3220 [FC/LC]))/(1 + 0.46%) = LC6,237.

[21] The line items used in this example are a possible presentation. Different presentation formats using different line items (including line items that include the amounts shown here) are also possible (PBE IPSAS 30 sets out disclosure requirements for hedge accounting that include disclosures about hedge ineffectiveness, the carrying amount of hedging instruments and the cash flow hedge reserve).

Example 16—Overview of Effect on Statements of Comprehensive Revenue and Expense and Financial Position *[All amounts in LC]*					
Period	**1**	**2**	**3**	**4**	**5**
Accumulated surplus or deficit					
Commodity hedge	0	0	(1,199)	1,582	(3,561)
FX hedge		0	76	0	291
	0	0	(1,123)	1,582	(3,270)
Total net assets/equity	0	20,258	(8,027)	12,150	(62,769)

IE126. The total cost of inventory after hedging is as follows:[22]

Cost of inventory [all amounts in LC]	
Cash price (at spot for commodity price risk and FX risk)	165,582
Gain/loss from CFHR for commodity price risk	(67,243)
Gain/loss from CFHR for FX risk	7,744
Cost of inventory	106,083

IE127. The total overall cash flow from all transactions (the actual electricity purchase at the spot price and the settlement of the two derivatives) is LC102,813. It differs from the hedge adjusted cost of inventory by LC3,270, which is the net amount of cumulative hedge ineffectiveness from the two hedging relationships. This hedge ineffectiveness has a cash flow effect but is excluded from the measurement of the inventory.

Example 17—Combined Interest Rate Risk and Foreign Currency Risk Hedge (Fair Value Hedge/Cash Flow Hedge Combination)

Fact Pattern

IE128. State Government B wants to hedge a fixed rate liability that is denominated in Foreign Currency (FC). The liability has a term of four periods from the start of Period 1 to the end of Period 4. State Government B's functional currency is its Local Currency (LC). State Government B has the following risk exposures:

(a) Fair value interest rate risk and FX risk: the changes in fair value of the fixed rate liability attributable to interest rate changes, measured in LC.

(b) Cash flow interest rate risk: the exposure that arises as a result of swapping the combined fair value interest rate risk and FX risk exposure associated with the fixed rate liability (see (a) above) into a variable rate exposure in LC in accordance with State Government B's risk management strategy for FC denominated fixed rate liabilities (see paragraph IE129(a) below).

IE129. State Government B hedges its risk exposures using the following risk management strategy:

(a) State Government B uses cross-currency interest rate swaps to swap its FC denominated fixed rate liabilities into a variable rate exposure in LC. State Government B hedges its FC denominated liabilities (including the interest) for their entire life. Consequently, State Government B enters into a cross-currency interest rate swap at the same time as it issues an FC denominated liability. Under the cross-currency interest rate swap State Government B receives fixed interest in FC (used to pay the interest on the liability) and pays variable interest in LC.

(b) State Government B considers the cash flows on a hedged liability and on the related cross-currency interest rate swap as one aggregated variable rate exposure in LC. From time to time, in accordance with its risk management strategy for variable rate interest rate risk (in LC), State Government B decides to lock in its interest payments and hence swaps its aggregated variable rate exposure in LC into a fixed rate exposure in LC. State Government B seeks to obtain as a fixed rate exposure a single blended fixed coupon rate (i.e., the uniform forward coupon rate for the hedged term that exists at the start of the hedging relationship).[23] Consequently, State

[22] 'CFHR' is the cash flow hedge reserve, i.e., the amount accumulated in other comprehensive revenue and expense for a cash flow hedge.

[23] An entity may have a different risk management strategy whereby it seeks to obtain a fixed rate exposure that is not a single blended rate but a series of forward rates that are each fixed for the respective individual interest period. For such a strategy the hedge effectiveness is measured based on the difference between the forward rates that existed at the start of the hedging relationship and the forward rates that exist at the effectiveness measurement date for the individual interest periods. For such a strategy a series of forward contracts

Government B uses interest rate swaps (denominated entirely in LC) under which it receives variable interest (used to pay the interest on the pay leg of the cross-currency interest rate swap) and pays fixed interest.

IE130. The following table sets out the parameters used for Example 17:

Example 17—Parameters	**t_0**	**Period 1**	**Period 2**	**Period 3**	**Period 4**
FX spot rate [LC/FC]	1.2000	1.0500	1.4200	1.5100	1.3700
Interest curves					
(vertical presentation of rates for each quarter of a period on a p.a. basis)					
LC	2.50%	5.02%	6.18%	0.34%	[N/A]
	2.75%	5.19%	6.26%	0.49%	
	2.91%	5.47%	6.37%	0.94%	
	3.02%	5.52%	6.56%	1.36%	
	2.98%	5.81%	6.74%		
	3.05%	5.85%	6.93%		
	3.11%	5.91%	7.19%		
	3.15%	6.06%	7.53%		
	3.11%	6.20%			
	3.14%	6.31%			
	3.27%	6.36%			
	3.21%	6.40%			
	3.21%				
	3.25%				
	3.29%				
	3.34%				
FC	3.74%	4.49%	2.82%	0.70%	[N/A]
	4.04%	4.61%	2.24%	0.79%	
	4.23%	4.63%	2.00%	1.14%	
	4.28%	4.34%	2.18%	1.56%	
	4.20%	4.21%	2.34%		
	4.17%	4.13%	2.53%		
	4.27%	4.07%	2.82%		
	4.14%	4.09%	3.13%		
	4.10%	4.17%			
	4.11%	4.13%			
	4.11%	4.24%			
	4.13%	4.34%			
	4.14%				
	4.06%				
	4.12%				
	4.19%				

Accounting Mechanics

IE131. State Government B designates the following hedging relationships:[24]

(a) As a fair value hedge, a hedging relationship for fair value interest rate risk and FX risk between the FC denominated fixed rate liability (fixed rate FX liability) as the hedged item and a cross-currency interest rate swap as the hedging instrument (the 'first level relationship'). This hedging relationship is designated at the beginning of Period 1 (i.e., t_0) with a term to the end of Period 4.

(b) As a cash flow hedge, a hedging relationship between the aggregated exposure as the hedged item and an interest rate swap as the hedging instrument (the 'second level relationship'). This hedging relationship is designated at the end of Period 1, when State Government B decides to lock in its interest payments and hence swaps its aggregated variable rate exposure in LC into a fixed rate exposure in LC, with a term to the end of Period 4. The aggregated exposure that is designated as

corresponding with the individual interest periods would be more effective than an interest rate swap (that has a fixed payment leg with a single blended fixed rate).

[24] This example assumes that all qualifying criteria for hedge accounting are met (see paragraph 129 of PBE IPSAS 41). The following description of the designation is solely for the purpose of understanding this example (i.e., it is not an example of the complete formal documentation required in accordance with paragraph 129(b) of PBE IPSAS 41.

the hedged item represents, in LC, the variability in cash flows that is the effect of changes in the combined cash flows of the two items designated in the fair value hedge of the fair value interest rate risk and FX risk (see (a) above), compared to the interest rates at the end of Period 1 (i.e., the time of designation of the hedging relationship between the aggregated exposure and the interest rate swap).

IE132. The following table[25] sets out the overview of the fair values of the derivatives, the changes in the value of the hedged items and the calculation of the cash flow hedge reserve and hedge ineffectiveness.[26] In this example, hedge ineffectiveness arises on both hedging relationships.[27]

Example 17—Calculations	**t_0**	**Period 1**	**Period 2**	**Period 3**	**Period 4**
Fixed rate FX liability					
Fair value [FC]	(1,000,000)	(995,522)	(1,031,008)	(1,030,193)	(1,000,000)
Fair value [LC]	(1,200,000)	(1,045,298)	(1,464,031)	(1,555,591)	(1,370,000)
Change in fair value [LC]		154,702	(418,733)	(91,560)	185,591
CCIRS (receive fixed FC/pay variable LC)					
Fair value [LC]	0	(154,673)	264,116	355,553	170,000
Change in fair value [LC]		(154,673)	418,788	91,437	(185,553)
IRS (receive variable/pay fixed)					
Fair value [LC]		0	18,896	(58,767)	0
Change in fair value [LC]			18,896	(77,663)	(58,767)
CF variability of the aggregated exposure					
Present value [LC]		0	(18,824)	58,753	0
Change in present value [LC]			(18,824)	77,577	(58,753)
CFHR					
Balance (end of period) [LC]		0	18,824	(58,753)	0
Change [LC]			18,824	(77,577)	58,753

IE133. The hedging relationship between the fixed rate FX liability and the cross-currency interest rate swap starts at the beginning of Period 1 (i.e., t_0) and remains in place when the hedging relationship for the second level relationship starts at the end of Period 1, i.e., the first level relationship continues as a separate hedging relationship.

IE134. The cash flow variability of the aggregated exposure is calculated as follows:

(a) At the point in time from which the cash flow variability of the aggregated exposure is hedged (i.e., the start of the second level relationship at the end of Period 1), all cash flows expected on the fixed rate FX liability and the cross-currency interest rate swap over the hedged term (i.e., until the end of Period 4) are mapped out and equated to a single blended fixed coupon rate so that the total present value (in LC) is nil. This calculation establishes the single blended fixed coupon rate (reference rate) that is used at subsequent dates as the reference point to measure the cash flow variability of the aggregated exposure since the start of the hedging relationship. This calculation is illustrated in the following table:

25 Tables in this example use the following acronyms: 'CCIRS' for cross-currency interest rate swap, 'CF(s)' for cash flow(s), 'CFH' for cash flow hedge, 'CFHR' for cash flow hedge reserve, 'FVH' for fair value hedge, 'IRS' for interest rate swap and 'PV' for present value.

26 In the following table for the calculations all amounts (including the calculations for accounting purposes of amounts for assets, liabilities and net assets/equity) are in the format of positive (plus) and negative (minus) numbers (e.g., an amount in the cash flow hedge reserve that is in brackets is a loss).

27 For a situation such as in this example, hedge ineffectiveness can result from various factors, for example credit risk, differences in the day count method or, depending on whether it is included in the designation of the hedging instrument, the charge for exchanging different currencies that is included in cross-currency interest rate swaps (commonly referred to as the 'currency basis').

Example 17—Cash Flow Variability of the Aggregated Exposure (Calibration)

		Variability in Cash Flows of the Aggregated Exposure							
		FX liability		**CCIRS FC leg**		**CCIRS LC leg**		**Calibration**	**PV**
		CF(s)	**PV**	**CF(s)**	**PV**	**CF(s)**	**PV**	**1,200,000 Nominal 5.6963% Rate 4 Frequency**	
		[FC]	**[FC]**	**[FC]**	**[FC]**	**[LC]**	**[LC]**	**[LC]**	**[LC]**
	Time								
Period 1	t_0								
	t_1								
	t_2								
	t_3								
	t_4								
Period 2	t_5	0	0	0	0	(14,771)	(14,591)	17,089	16,881
	t_6	(20,426)	(19,977)	20,246	19,801	(15,271)	(14,896)	17,089	16,669
	t_7	0	0	0	0	(16,076)	(15,473)	17,089	16,449
	t_8	(20,426)	(19,543)	20,582	19,692	(16,241)	(15,424)	17,089	16,229
Period 3	t_9	0	0	0	0	(17,060)	(15,974)	17,089	16,002
	t_{10}	(20,426)	(19,148)	20,358	19,084	(17,182)	(15,862)	17,089	15,776
	t_{11}	0	0	0	0	(17,359)	(15,797)	17,089	15,551
	t_{12}	(20,426)	(18,769)	20,582	18,912	(17,778)	(15,942)	17,089	15,324
Period 4	t_{13}	0	0	0	0	(18,188)	(16,066)	17,089	15,095
	t_{14}	(20,426)	(18,391)	20,246	18,229	(18,502)	(16,095)	17,089	14,866
	t_{15}	0	0	0	0	(18,646)	(15,972)	17,089	14,638
	t_{16}	(1,020,426)	(899,695)	1,020,582	899,832	(1,218,767)	(1,027,908)	1,217,089	1,026,493
Totals			(995,522)		995,550		(1,200,000)		1,199,971
Totals in LC			(1,045,298)		1,045,327		(1,200,000)		1,199,971
PV of all CF(s) [LC]			0 ←			Σ			

The nominal amount that is used for the calibration of the reference rate is the same as the nominal amount of aggregated exposure that creates the variable cash flows in LC (LC1,200,000), which coincides with the nominal amount of the cross-currency interest rate swap for the variable rate leg in LC. This results in a reference rate of 5.6963 per cent (determined by iteration so that the present value of all cash flows in total is nil).

(b) At subsequent dates, the cash flow variability of the aggregated exposure is determined by comparison to the reference point established at the end of Period 1. For that purpose, all remaining cash flows expected on the fixed rate FX liability and the cross-currency interest rate swap over the remainder of the hedged term (i.e., from the effectiveness measurement date until the end of Period 4) are updated (as applicable) and then discounted. Also, the reference rate of 5.6963 per cent is applied to the nominal amount that was used for the calibration of that rate at the end of Period 1 (LC1,200,000) in order to generate a set of cash flows over the remainder of the hedged term that is then also discounted. The total of all those present values represents the cash flow variability of the aggregated exposure. This calculation is illustrated in the following table for the end of Period 2:

Example 17—Cash Flow Variability of the Aggregated Exposure (at the End of Period 2)

		Variability in Cash Flows of the Aggregated Exposure							
		FX liability		**CCIRS FC leg**		**CCIRS LC leg**		**Calibration**	**PV**
		CF(s)	**PV**	**CF(s)**	**PV**	**CF(s)**	**PV**	**1,200,000 Nominal 5.6963% Rate 4 Frequency**	
		[FC]	**[FC]**	**[FC]**	**[FC]**	**[LC]**	**[LC]**	**[LC]**	**[LC]**
	Time								
	t_0								
	t_1								
Period 1	t_2								
	t_3								
	t_4								
	t_5	0	0	0	0	0	0	0	0
Period 2	t_6	0	0	0	0	0	0	0	0
	t_7	0	0	0	0	0	0	0	0
	t_8	0	0	0	0	0	0	0	0
	t_9	0	0	0	0	(18,120)	(17,850)	17,089	16,835
Period 3	t_{10}	(20,426)	(20,173)	20,358	20,106	(18,360)	(17,814)	17,089	16,581
	t_{11}	0	0	0	0	(18,683)	(17,850)	17,089	16,327
	t_{12}	(20,426)	(19,965)	20,582	20,117	(19,203)	(18,058)	17,089	16,070
	t_{13}	0	0	0	0	(19,718)	(18,243)	17,089	15,810
Period 4	t_{14}	(20,426)	(19,726)	20,246	19,553	(20,279)	(18,449)	17,089	15,547
	t_{15}	0	0	0	0	(21,014)	(18,789)	17,089	15,280
	t_{16}	(1,020,426)	(971,144)	1,020,582	971,292	(1,221,991)	(1,072,947)	1,217,089	1,068,643
Totals			(1,031,008)		1,031,067		(1,200,000)		1,181,092
Totals in LC			(1,464,031)		1,464,116		(1,200,000)		1,181,092
PV of all CF(s) [LC]			(18,824)			Σ			

The changes in interest rates and the exchange rate result in a change of the cash flow variability of the aggregated exposure between the end of Period 1 and the end of Period 2 that has a present value of LC-18,824.[28]

IE135. Using the present value of the hedged item and the fair value of the hedging instrument, the cash flow hedge reserve and the hedge ineffectiveness are then determined (see paragraph 140 of PBE IPSAS 41).

IE136. The following table shows the effect on State Government B's statement of comprehensive revenue and expense and its statement of financial position (for the sake of transparency some line items[29] are disaggregated on the face of the statements by the two hedging relationships, i.e., for the fair value hedge of the fixed rate FX liability and the cash flow hedge of the aggregated exposure):[30]

[28] This is the amount that is included in the table with the overview of the calculations (see paragraph IE132) as the present value of the cash flow variability of the aggregated exposure at the end of Period 2.

[29] The line items used in this example are a possible presentation. Different presentation formats using different line items (including line items that include the amounts shown here) are also possible (PBE IPSAS 30 sets out disclosure requirements for hedge accounting that include disclosures about hedge ineffectiveness, the carrying amount of hedging instruments and the cash flow hedge reserve).

[30] For Period 4 the values in the table with the overview of the calculations (see paragraph IE132) differ from those in the following table. For Periods 1 to 3 the 'dirty' values (i.e., including interest accruals) equal the 'clean' values (i.e., excluding interest accruals) because the period end is a settlement date for all legs of the derivatives and the fixed rate FX liability. At the end of Period 4 the table with the overview of the calculations uses clean values in order to calculate the value changes consistently over time. For the following table the dirty values are presented, i.e., the maturity amounts including accrued interest immediately before the instruments are settled (this is for illustrative purposes as otherwise all carrying amounts other than cash and ~~retained earnings~~accumulated comprehensive revenue and expense would be nil).

Example 17—Overview of Effect on Statements of Comprehensive Revenue and Expense and Financial Position
[All amounts in LC]

	t_0	Period 1	Period 2	Period 3	Period 4
Statement of comprehensive revenue and expense					
Interest expense					
FX liability		45,958	50,452	59,848	58,827
FVH adjustment		(12,731)	11,941	14,385	(49,439)
		33,227	62,393	74,233	9,388
Reclassifications (CFH)			5,990	(5,863)	58,982
Total interest expense		33,227	68,383	68,370	68,370
Other gains/losses					
Change in fair value of the CCIRS		154,673	(418,788)	(91,437)	185,553
FVH adjustment (FX liability)		(154,702)	418,733	91,560	(185,591)
Hedge ineffectiveness		0	(72)	(54)	(19)
Total other gains/losses		(29)	(127)	68	(57)
Surplus or deficit		33,198	68,255	68,438	68,313
Other comprehensive revenue and expense					
Effective CFH gain/loss			(12,834)	71,713	229
Reclassifications			(5,990)	5,863	(58,982)
Total other comprehensive revenue and expense			(18,842)	77,577	(58,753)
Comprehensive revenue and expense		33,198	49,432	146,015	9,560

	t_0	Period 1	Period 2	Period 3	Period 4
Statement of financial position					
FX liability	(1,200,000)	(1,045,298)	(1,464,031)	(1,555,591)	(1,397,984)
CCIRS	0	(154,673)	264,116	355,553	194,141
IRS		0	18,896	(58,767)	(13,004)
Cash	1,200,000	1,166,773	1,098,390	1,030,160	978,641
Total net assets	0	(33,198)	(82,630)	(228,645)	(238,205)
Net assets/equity					
Accumulated other comprehensive revenue and expense		0	(18,824)	58,753	0
Accumulated surplus or deficit	0	33,198	101,454	169,892	238,205
Total net assets/equity	0	33,198	82,630	228,645	238,205

IE137. The total interest expense in surplus or deficit reflects State Government B's interest expense that results from its risk management strategy:

(a) In Period 1 the risk management strategy results in interest expense reflecting variable interest rates in LC after taking into account the effect of the cross-currency interest rate swap, including a difference between the cash flows on the fixed rate FX liability and the fixed leg of the cross-currency interest rate swap that were settled during Period 1 (this means the interest expense does not exactly equal the variable interest expense that would arise in LC on a borrowing of LC1,200,000). There is also some hedge ineffectiveness that results from a difference in the changes in value for the fixed rate FX liability (as represented by the fair value hedge adjustment) and the cross-currency interest rate swap.

(b) For Periods 2 to 4 the risk management strategy results in interest expense that reflects, after taking into account the effect of the interest rate swap entered into at the end of Period 1, fixed interest rates in LC (i.e., locking in a single blended fixed coupon rate for a three-period term based on the interest rate environment at the end of Period 1). However, State Government B's interest expense is affected by the hedge ineffectiveness that arises on its hedging relationships. In Period 2 the interest expense is slightly higher than the fixed rate payments locked in with the interest rate swap because the variable payments received under the interest rate swap are less than the total of the cash flows resulting from the aggregated exposure.[31] In Periods 3 and 4 the

[31] In other words, the cash flow variability of the interest rate swap was lower than, and therefore did not fully offset, the cash flow variability of the aggregated exposure as a whole (sometimes called an 'underhedge' situation). In those situations the cash flow hedge does not

interest expense is equal to the locked in rate because the variable payments received under the swap are more than the total of the cash flows resulting from the aggregated exposure.[32]

Example 18—Combined Interest Rate Risk and Foreign Currency Risk Hedge (Cash Flow Hedge/Fair Value Hedge Combination)

Fact Pattern

IE138. State Government C wants to hedge a variable rate liability that is denominated in Foreign Currency (FC). The liability has a term of four periods from the start of Period 1 to the end of Period 4. State Government C's functional currency is its Local Currency (LC). State Government C has the following risk exposures:

(a) Cash flow interest rate risk and FX risk: the changes in cash flows of the variable rate liability attributable to interest rate changes, measured in LC.

(b) Fair value interest rate risk: the exposure that arises as a result of swapping the combined cash flow interest rate risk and FX risk exposure associated with the variable rate liability (see (a) above) into a fixed rate exposure in LC in accordance with State Government C's risk management strategy for FC denominated variable rate liabilities (see paragraph IE139(a) below).

IE139. State Government C hedges its risk exposures using the following risk management strategy:

(a) State Government C uses cross-currency interest rate swaps to swap its FC denominated variable rate liabilities into a fixed rate exposure in LC. State Government C hedges its FC denominated liabilities (including the interest) for their entire life. Consequently, State Government C enters into a cross-currency interest rate swap at the same time as it issues an FC denominated liability. Under the cross-currency interest rate swap State Government C receives variable interest in FC (used to pay the interest on the liability) and pays fixed interest in LC.

(b) State Government C considers the cash flows on a hedged liability and on the related cross-currency interest rate swap as one aggregated fixed rate exposure in LC. From time to time, in accordance with its risk management strategy for fixed rate interest rate risk (in LC), State Government C decides to link its interest payments to current variable interest rate levels and hence swaps its aggregated fixed rate exposure in LC into a variable rate exposure in LC. Consequently, State Government C uses interest rate swaps (denominated entirely in LC) under which it receives fixed interest (used to pay the interest on the pay leg of the cross-currency interest rate swap) and pays variable interest.

contribute to the hedge ineffectiveness that is recognised in surplus or deficit because the hedge ineffectiveness is not recognised (see paragraph 140 of PBE IPSAS 41). The hedge ineffectiveness arising on the fair value hedge affects surplus or deficit in all periods.

32 In other words, the cash flow variability of the interest rate swap was higher than, and therefore more than fully offset, the cash flow variability of the aggregated exposure as a whole (sometimes called an 'overhedge' situation). In those situations the cash flow hedge contributes to the hedge ineffectiveness that is recognised in surplus or deficit (see paragraph 140 of PBE IPSAS 41). The hedge ineffectiveness arising on the fair value hedge affects surplus or deficit in all periods.

IE140. The following table sets out the parameters used for Example 18:

Example 18—Parameter Overview	t_0	Period 1	Period 2	Period 3	Period 4
FX spot rate [LC/FC]	1.2	1.05	1.42	1.51	1.37
Interest curves (vertical presentation of rates for each quarter of a period on a p.a. basis)					
LC	2.50%	1.00%	3.88%	0.34%	[N/A]
	2.75%	1.21%	4.12%	0.49%	
	2.91%	1.39%	4.22%	0.94%	
	3.02%	1.58%	5.11%	1.36%	
	2.98%	1.77%	5.39%		
	3.05%	1.93%	5.43%		
	3.11%	2.09%	5.50%		
	3.15%	2.16%	5.64%		
	3.11%	2.22%			
	3.14%	2.28%			
	3.27%	2.30%			
	3.21%	2.31%			
	3.21%				
	3.25%				
	3.29%				
	3.34%				
FC	3.74%	4.49%	2.82%	0.70%	[N/A]
	4.04%	4.61%	2.24%	0.79%	
	4.23%	4.63%	2.00%	1.14%	
	4.28%	4.34%	2.18%	1.56%	
	4.20%	4.21%	2.34%		
	4.17%	4.13%	2.53%		
	4.27%	4.07%	2.82%		
	4.14%	4.09%	3.13%		
	4.10%	4.17%			
	4.11%	4.13%			
	4.11%	4.24%			
	4.13%	4.34%			
	4.14%				
	4.06%				
	4.12%				
	4.19%				

Accounting Mechanics

IE141. State Government C designates the following hedging relationships:[33]

(a) As a cash flow hedge, a hedging relationship for cash flow interest rate risk and FX risk between the FC denominated variable rate liability (variable rate FX liability) as the hedged item and a cross-currency interest rate swap as the hedging instrument (the ‘first level relationship’). This hedging relationship is designated at the beginning of Period 1 (i.e., t_0) with a term to the end of Period 4.

(b) As a fair value hedge, a hedging relationship between the aggregated exposure as the hedged item and an interest rate swap as the hedging instrument (the ‘second level relationship’). This hedging relationship is designated at the end of Period 1, when State Government C decides to link its interest payments to current variable interest rate levels and hence swaps its aggregated fixed rate exposure in LC into a variable rate exposure in LC, with a term to the end of Period 4. The aggregated exposure that is designated as the hedged item represents, in LC, the change in value that is the effect of changes in the value of the combined cash flows of the two items designated in the cash flow hedge of the cash flow interest rate risk and FX risk (see (a) above), compared to

[33] This example assumes that all qualifying criteria for hedge accounting are met (see paragraph 129 of PBE IPSAS 41). The following description of the designation is solely for the purpose of understanding this example (i.e., it is not an example of the complete formal documentation required in accordance with paragraph 129(b) of PBE IPSAS 41).

the interest rates at the end of Period 1 (i.e., the time of designation of the hedging relationship between the aggregated exposure and the interest rate swap).

IE142. The following table[34] sets out the overview of the fair values of the derivatives, the changes in the value of the hedged items and the calculation of the cash flow hedge reserve.[35] In this example no hedge ineffectiveness arises on either hedging relationship because of the assumptions made.[36]

Example 18—Calculations	**t_0**	**Period 1**	**Period 2**	**Period 3**	**Period 4**
Variable rate FX liability					
Fair value [FC]	(1,000,000)	(1,000,000)	(1,000,000)	(1,000,000)	(1,000,000)
Fair value [LC]	(1,200,000)	(1,050,000)	(1,420,000)	(1,510,000)	(1,370,000)
Change in fair value [LC]		150,000	(370,000)	(90,000)	140,000
PV of change in variable CF(s) [LC]	0	192,310	(260,346)	(282,979)	(170,000)
Change in PV [LC]		192,310	(452,656)	(22,633)	112,979
CCIRS (receive variable FC/pay fixed LC)					
Fair value [LC]	0	(192,310)	260,346	282,979	170,000
Change in fair value [LC]		(192,310)	452,656	22,633	(112,979)
	t_0	**Period 1**	**Period 2**	**Period 3**	**Period 4**
CFHR					
Opening balance	0	0	(42,310)	(28,207)	(14,103)
Reclassification FX risk		153,008	(378,220)	(91,030)	140,731
Reclassification (current period CF)		(8,656)	(18,410)	2,939	21,431
Effective CFH gain/loss		(186,662)	(479,286)	20,724	(135,141)
Reclassification for interest rate risk		0	(82,656)	67,367	(27,021)
Amortisation of CFHR		0	14,103	14,103	14,103
Ending balance		(42,103)	(28,207)	(14,103)	0
IRS (receive fixed/pay variable)					
Fair value [LC]		0	(82,656)	(15,289)	(42,310)
Change in fair value			(82,656)	67,367	(27,021)
Change in present value of the aggregated exposure					
Present value [LC]		(1,242,310)	(1,159,654)	(1,227,021)	(1,200,000)
Change in present value [LC]			82,656	(67,367)	27,021

IE143. The hedging relationship between the variable rate FX liability and the cross-currency interest rate swap starts at the beginning of Period 1 (i.e., t_0) and remains in place when the hedging relationship for the second level relationship starts at the end of Period 1, i.e., the first level relationship continues as a separate hedging relationship. However, the hedge accounting for the first level relationship is affected by the start of hedge accounting for the second level relationship at the end of Period 1. The fair value hedge for the second level relationship affects the timing of the reclassification to surplus or deficit of amounts from the cash flow hedge reserve for the first level relationship:

(a) The fair value interest rate risk that is hedged by the fair value hedge is included in the amount that is recognised in other comprehensive revenue and expense as a result of the cash flow hedge for the first level hedging relationship (i.e., the gain or loss on the cross-currency interest rate

[34] Tables in this example use the following acronyms: 'CCIRS' for cross-currency interest rate swap, 'CF(s)' for cash flow(s), 'CFH' for cash flow hedge, 'CFHR' for cash flow hedge reserve, 'FVH' for fair value hedge, 'IRS' for interest rate swap and 'PV' for present value.

[35] In the following table for the calculations all amounts (including the calculations for accounting purposes of amounts for assets, liabilities and net assets/equity) are in the format of positive (plus) and negative (minus) numbers (e.g., an amount in the cash flow hedge reserve that is a negative number is a loss).

[36] Those assumptions have been made for didactical reasons, in order to better focus on illustrating the accounting mechanics in a cash flow hedge/fair value hedge combination. The measurement and recognition of hedge ineffectiveness has already been demonstrated in Example 16 and Example 17. However, in reality such hedges are typically not perfectly effective because hedge ineffectiveness can result from various factors, for example credit risk, differences in the day count method or, depending on whether it is included in the designation of the hedging instrument, the charge for exchanging different currencies that is included in cross-currency interest rate swaps (commonly referred to as the 'currency basis').

swap that is determined to be an effective hedge).[37] This means that from the end of Period 1 the part of the effective cash flow hedging gain or loss that represents the fair value interest rate risk (in LC), and is recognised in other comprehensive revenue and expense in a first step, is in a second step immediately (i.e., in the same period) transferred from the cash flow hedge reserve to surplus or deficit. That reclassification adjustment offsets the gain or loss on the interest rate swap that is recognised in surplus or deficit.[38] In the context of accounting for the aggregated exposure as the hedged item, that reclassification adjustment is the equivalent of a fair value hedge adjustment because in contrast to a hedged item that is a fixed rate debt instrument (in LC) at amortised cost, the aggregated exposure is already remeasured for changes regarding the hedged risk but the resulting gain or loss is recognised in other comprehensive revenue and expense because of applying cash flow hedge accounting for the first level relationship. Consequently, applying fair value hedge accounting with the aggregated exposure as the hedged item does not result in changing the hedged item's measurement but instead affects where the hedging gains and losses are recognised (i.e., reclassification from the cash flow hedge reserve to surplus or deficit).

(b) The amount in the cash flow hedge reserve at the end of Period 1 (LC42,310) is amortised over the remaining life of the cash flow hedge for the first level relationship (i.e., over Periods 2 to 4).[39]

IE144. The change in value of the aggregated exposure is calculated as follows:

(a) At the point in time from which the change in value of the aggregated exposure is hedged (i.e., the start of the second level relationship at the end of Period 1), all cash flows expected on the variable rate FX liability and the cross-currency interest rate swap over the hedged term (i.e., until the end of Period 4) are mapped out and their combined present value, in LC, is calculated. This calculation establishes the present value that is used at subsequent dates as the reference point to measure the change in present value of the aggregated exposure since the start of the hedging relationship. This calculation is illustrated in the following table:

[37] As a consequence of hedging its exposure to cash flow interest rate risk by entering into the cross-currency interest rate swap that changed the cash flow interest rate risk of the variable rate FX liability into a fixed rate exposure (in LC), State Government C in effect assumed an exposure to fair value interest rate risk (see paragraph IE139).

[38] In the table with the overview of the calculations (see paragraph IE142) this reclassification adjustment is the line item "Reclassification for interest rate risk" in the reconciliation of the cash flow hedge reserve (e.g., at the end of Period 2 a reclassification of a gain of LC82,656 from the cash flow hedge reserve to surplus or deficit—see paragraph IE144 for how that amount is calculated).

[39] In the table with the overview of the calculations (see paragraph IE142) this amortisation results in a periodic reclassification adjustment of LC14,103 that is included in the line item "Amortisation of CFHR" in the reconciliation of the cash flow hedge reserve.

Example 18—Present Value of the Aggregated Exposure (Starting Point)							
		Present Value of the Aggregated Exposure					
		FX liability		**CCIRS FC leg**		**CCIRS LC leg**	
		CF(s) [FC]	**PV [FC]**	**CF(s) [FC]**	**PV [FC]**	**CF(s) [LC]**	**PV [LC]**
	Time						
Period 1	t_0						
	t_1						
	t_2						
	t_3						
	t_4						
Period 2	t_5	(11,039)	(10,918)	11,039	10,918	(9,117)	(9,094)
	t_6	(11,331)	(11,082)	11,331	11,082	(9,117)	(9,067)
	t_7	(11,375)	(11,000)	11,375	11,000	(9,117)	(9,035)
	t_8	(10,689)	(10,227)	10,689	10,227	(9,117)	(9,000)
Period 3	t_9	(10,375)	(9,824)	10,375	9,824	(9,117)	(8,961)
	t_{10}	(10,164)	(9,528)	10,164	9,528	(9,117)	(8,918)
	t_{11}	(10,028)	(9,307)	10,028	9,307	(9,117)	(8,872)
	t_{12}	(10,072)	(9,255)	10,072	9,255	(9,117)	(8,825)
Period 4	t_{13}	(10,256)	(9,328)	10,256	9,328	(9,117)	(8,776)
	t_{14}	(10,159)	(9,147)	10,159	9,147	(9,117)	(8,727)
	t_{15}	(10,426)	(9,290)	10,426	9,290	(9,117)	(8,678)
	t_{16}	(1,010,670)	(891,093)	1,010,670	891,093	(1,209,117)	(1,144,358)
	Totals		(1,000,000)		1,000,000		(1,242,310)
	Totals in LC		(1,050,000)		1,050,000		(1,242,310)
PV of aggregated exposure [LC]							
			(1,242,310) ◄ Σ				

The present value of all cash flows expected on the variable rate FX liability and the cross-currency interest rate swap over the hedged term at the end of Period 1 is LC-1,242,310.[40]

(b) At subsequent dates, the present value of the aggregated exposure is determined in the same way as at the end of Period 1 but for the remainder of the hedged term. For that purpose, all remaining cash flows expected on the variable rate FX liability and the cross-currency interest rate swap over the remainder of the hedged term (i.e., from the effectiveness measurement date until the end of Period 4) are updated (as applicable) and then discounted. The total of those present values represents the present value of the aggregated exposure. This calculation is illustrated in the following table for the end of Period 2:

[40] In this example no hedge ineffectiveness arises on either hedging relationship because of the assumptions made (see paragraph IE142). Consequently, the absolute values of the variable rate FX liability and the FC denominated leg of the cross-currency interest rate are equal (but with opposite signs). In situations in which hedge ineffectiveness arises, those absolute values would not be equal so that the remaining net amount would affect the present value of the aggregated exposure.

Example 18—Present Value of the Aggregated Exposure (at the End of Period 2)							
		Present Value of the Aggregated Exposure					
		FX liability		**CCIRS FC leg**		**CCIRS LC leg**	
		CF(s) [FC]	**PV [FC]**	**CF(s) [FC]**	**PV [FC]**	**CF(s) [LC]**	**PV [LC]**
	Time						
Period 1	t_0						
	t_1						
	t_2						
	t_3						
	t_4						
Period 2	t_5	0	0	0	0	0	0
	t_6	0	0	0	0	0	0
	t_7	0	0	0	0	0	0
	t_8	0	0	0	0	0	0
Period 3	t_9	(6,969)	(6,921)	6,969	6,921	(9,117)	(9,030)
	t_{10}	(5,544)	(5,475)	5,544	5,475	(9,117)	(8,939)
	t_{11}	(4,971)	(4,885)	4,971	4,885	(9,117)	(8,847)
	t_{12}	(5,401)	(5,280)	5,401	5,280	(9,117)	(8,738)
Period 4	t_{13}	(5,796)	(5,632)	5,796	5,632	(9,117)	(8,624)
	t_{14}	(6,277)	(6,062)	6,277	6,062	(9,117)	(8,511)
	t_{15}	(6,975)	(6,689)	6,975	6,689	(9,117)	(8,397)
	t_{16}	(1,007,725)	(959,056)	1,007,725	956,056	(1,209,117)	(1,098,568)
	Totals		(1,000,000)		1,000,000		(1,159,654)
	Totals in LC		(1,420,000)		1,420,000		(1,159,654)
PV of aggregated exposure [LC]			(1,159,654) ◄		Σ		

(1,159,654)

The changes in interest rates and the exchange rate result in a present value of the aggregated exposure at the end of Period 2 of LC-1,159,654. Consequently, the change in the present value of the aggregated exposure between the end of Period 1 and the end of Period 2 is a gain of LC82,656.[41]

IE145. Using the change in present value of the hedged item (i.e., the aggregated exposure) and the fair value of the hedging instrument (i.e., the interest rate swap), the related reclassifications from the cash flow hedge reserve to surplus or deficit (reclassification adjustments) are then determined.

IE146. The following table shows the effect on State Government C's statement of comprehensive revenue and expense and its statement of financial position (for the sake of transparency some line items[42] are disaggregated on the face of the statements by the two hedging relationships, i.e., for the cash flow hedge of the variable rate FX liability and the fair value hedge of the aggregated exposure):[43]

[41] This is the amount that is included in the table with the overview of the calculations (see paragraph IE142) as the change in present value of the aggregated exposure at the end of Period 2.

[42] The line items used in this example are a possible presentation. Different presentation formats using different line items (including line items that include the amounts shown here) are also possible (PBE IPSAS 30 sets out disclosure requirements for hedge accounting that include disclosures about hedge ineffectiveness, the carrying amount of hedging instruments and the cash flow hedge reserve).

[43] For Period 4 the values in the table with the overview of the calculations (see paragraph IE142) differ from those in the following table. For Periods 1 to 3 the 'dirty' values (i.e., including interest accruals) equal the 'clean' values (i.e., excluding interest accruals) because the period end is a settlement date for all legs of the derivatives and the fixed rate FX liability. At the end of Period 4 the table with the overview of the calculations uses clean values in order to calculate the value changes consistently over time. For the following table the dirty values are presented, i.e., the maturity amounts including accrued interest immediately before the instruments are settled (this is for illustrative purposes as otherwise all carrying amounts other than cash and accumulated surplus or deficit would be nil).

Example 18—Overview of Effect on Statements of Comprehensive Revenue and Expense and Financial Position
[All amounts in LC]

	t_0	Period 1	Period 2	Period 3	Period 4
Statement of comprehensive revenue and expense					
Interest expense					
FX liability		45,122	54,876	33,527	15,035
FVH adjustment		0	(20,478)	16,517	(26,781)
		45,122	34,398	50,045	(11,746)
Reclassifications (CFH)		(8,656)	(18,410)	2,939	21,431
		36,466	15,989	52,983	9,685
Amortisation of CFHR		0	14,103	14,103	14,103
Total interest expense		36,466	30,092	67,087	23,788
Other gains/losses					
IRS		0	82,656	(67,367)	27,021
FX gain/loss (liability)		(150,000)	370,000	90,000	(140,000)
FX gain/loss (interest)		(3,008)	8,220	1,030	(731)
Reclassification for FX risk		153,008	(378,220)	(91,030)	140,731
Reclassification for interest rate risk		0	(82,656)	67,367	(27,021)
Total other gains/losses		0	0	0	0
Surplus or deficit		36,466	30,092	67,087	23,788
Other comprehensive revenue and expense					
Effective gain/loss		186,662	(479,286)	(20,724)	135,141
Reclassification (current period CF)		8,656	18,410	(2,939)	(21,431)
Reclassification for FX risk		(153,008)	378,220	91,030	(140,731)
Reclassification for interest rate risk		0	82,656	(67,367)	27,021
Amortisation of CFHR		0	(14,103)	(14,103)	(14,103)
Total other comprehensive revenue and expense		42,310	(14,103)	(14,103)	(14,103)
Comprehensive revenue and expense		78,776	15,989	52,983	9,685

	t_0	Period 1	Period 2	Period 3	Period 4
Statement of financial position					
FX liability	(1,200,000)	(1,050,000)	(1,420,000)	(1,510,000)	(1,375,306)
CCIRS	0	(192,310)	260,346	282,979	166,190
IRS		0	(82,656)	(15,289)	(37,392)
Cash	1,200,000	1,163,534	1,147,545	1,094,562	1,089,076
Total net assets/equity	0	(78,776)	(94,765)	(147,748)	(157,433)
Accumulated other comprehensive revenue and expense	0	42,310	28,207	14,103	0
Accumulated surplus or deficit	0	36,466	66,558	133,645	157,433
Total net assets/equity	0	78,776	94,765	147,748	157,433

IE147. The total interest expense in surplus or deficit reflects State Government C's interest expense that results from its risk management strategy:

(a) In Period 1 the risk management strategy results in interest expense reflecting fixed interest rates in LC after taking into account the effect of the cross-currency interest rate swap.

(b) For Periods 2 to 4, after taking into account the effect of the interest rate swap entered into at the end of Period 1, the risk management strategy results in interest expense that changes with variable interest rates in LC (i.e., the variable interest rate prevailing in each period). However, the amount of the total interest expense is not equal to the amount of the variable rate interest because of the amortisation of the amount that was in the cash flow hedge reserve for the first level relationship at the end of Period 1.[44]

Foreign Operations (Appendix B)

IE148. This example illustrates the application of paragraphs B12, B13, B14 and B15 of Appendix B in connection with the reclassification adjustment on the disposal of a foreign operation.

44 See paragraph IE143(b). That amortisation becomes an expense that has an effect like a spread on the variable interest rate.

Example 19—Disposal of a Foreign Operation

Background

IE149. This example assumes the economic entity structure set out in paragraph B16 and that Controlling Entity D used a USD borrowing in Controlled Entity A to hedge the EUR/USD risk of the net investment in Controlled Entity C in Controlling Entity D's consolidated financial statements. Controlling Entity D uses the step-by-step method of consolidation. Assume the hedge was fully effective and the full USD/EUR accumulated change in the value of the hedging instrument before disposal of Controlled Entity C is €24 million (gain). This is matched exactly by the fall in value of the net investment in Controlled Entity C, when measured against the functional currency of Controlling Entity D (euro).

IE150. If the direct method of consolidation is used, the fall in the value of Controlling Entity D's net investment in Controlled Entity C of €24 million would be reflected totally in the foreign currency translation reserve relating to Controlled Entity C in Controlling Entity D's consolidated financial statements. However, because Controlling Entity D uses the step-by-step method, this fall in the net investment value in Controlled Entity C of €24 million would be reflected both in Controlled Entity B's foreign currency translation reserve relating to Controlled Entity C and in Controlling Entity D's foreign currency translation reserve relating to Controlled Entity B.

IE151. The aggregate amount recognised in the foreign currency translation reserve in respect of Controlled Entities B and C is not affected by the consolidation method. Assume that using the direct method of consolidation, the foreign currency translation reserves for Controlled Entities B and C in Controlling Entity D's consolidated financial statements are €62 million gain and €24 million loss respectively; using the step-by-step method of consolidation those amounts are €49 million gain and €11 million loss respectively.

Reclassification

IE152. When the investment in Controlled Entity C is disposed of, PBE IPSAS 41 requires the full €24 million gain on the hedging instrument to be reclassified in surplus or deficit. Using the step-by-step method, the amount to be reclassified to surplus or deficit in respect of the net investment in Controlled Entity C would be only €11 million loss. Controlling Entity D could adjust the foreign currency translation reserves of both Controlled Entities B and C by €13 million in order to match the amounts reclassified in respect of the hedging instrument and the net investment as would have been the case if the direct method of consolidation had been used, if that was its accounting policy. An entity that had not hedged its net investment could make the same reclassification.

Concessionary Loans (paragraphs AG118–AG126)

Example 20—Receipt of a Concessionary Loan (Interest Concession)

IE153. A local authority receives loan funding to the value of CU5 million from an international development agency to build primary healthcare clinics over a period of 5 years. The agreement stipulates that the loan is to be repaid over the 5 year period as follows:

Year 1: no principal repayments

Year 2: 10 per cent of the principal

Year 3: 20 per cent of the principal

Year 4: 30 per cent of the principal

Year 5: 40 per cent of the principal

Interest is paid annually in arrears, at a rate of 5 per cent per annum on the outstanding balance of the loan. A market-related rate of interest for a similar transaction is 10 per cent.

IE154. The local authority has received a concessionary loan of CU5 million, which will be repaid at 5 per cent below the current market interest rate. The difference between the proceeds of the loan and the present value of the contractual payments in terms of the loan agreement, discounted using the market-related rate of interest, is recognised in accordance with PBE IPSAS 23 *Revenue from Non-Exchange Transactions*.

IE155. The journal entries to account for the concessionary loan are as follows:

1. On initial recognition, the entity recognises the following:

Dr	Bank	5,000,000	
Cr	Loan (refer to Table 2 below)		4,215,450
Cr	Liability or non-exchange revenue		784,550

Recognition of the receipt of the loan at fair value
PBE IPSAS 23 is considered in recognising either a liability or revenue for the off-market portion of the loan. Paragraph IG54 of that Standard provides journal entries for the recognition and measurement of the off-market portion of the loan deemed to be non-exchange revenue.

2. Year 1: The entity recognises the following:

Dr	Interest (refer to Table 3 below)	421,545	
Cr	Loan		421,545

Recognition of interest using the effective interest method (CU4,215,450 × 10 per cent)

Dr	Loan (refer to Table 1 below)	250,000	
Cr	Bank		250,000

Recognition of interest paid on outstanding balance (CU5m × 5 per cent)

3. Year 2: The entity recognises the following:

Dr	Interest	438,700	
Cr	Loan		438,700

Recognition of interest using the effective interest method (CU4,386,995 × 10 per cent)

Dr	Loan	750,000	
Cr	Bank		750,000

Recognition of interest and principal paid on outstanding balance (CU5m × 5 per cent + CU500,000)

4. Year 3: The entity recognises the following:

Dr	Interest	407,569	
Cr	Loan		407,569

Recognition of interest using the effective interest method (CU4,075,695 × 10 per cent)

Dr	Loan	1,225,000	
Cr	Bank		1,225,000

Recognition of interest and principal paid on outstanding balance (CU4.5m × 5 per cent + CU1m)

5. Year 4: The entity recognises the following:

Dr	Interest	325,827	
Cr	Loan		325,827

Recognition of interest using the effective interest method (CU 3,258,264 × 10 per cent)

Dr	Loan	1,675,000	
Cr	Bank		1,675,000

Recognition of interest and principal paid on outstanding balance (CU3.5m × 5 per cent + CU1.5m)

6. Year 5: The entity recognises the following:

Dr	Interest	190,909	
Cr	Loan		190,909

Recognition of interest using the effective interest method (CU1,909,091 × 10 per cent)

Dr	Loan	2,100,000	
Cr	Bank		2,100,000

Recognition of interest and principal paid on outstanding balance (CU2m × 5 per cent + CU2m)

Calculations:

Table 1: Amortisation Schedule (Using Contractual Repayments at 5 per cent Interest)

	Year 0 **CU**	**Year 1** **CU**	**Year 2** **CU**	**Year 3** **CU**	**Year 4** **CU**	**Year 5** **CU**
Principal	5,000,000	5,000,000	5,000,000	4,500,000	3,500,000	2,000,000
Interest	–	250,000	250,000	225,000	175,000	100,000
Payments	–	(250,000)	(750,000)	(1,225,000)	(1,675,000)	(2,100,000)
Balance	**5,000,000**	**5,000,000**	**4,500,000**	**3,500,000**	**2,000,000**	–

Table 2: Discounting Contractual Cash Flows (Based on a Market Rate of 10 per cent)

	Year 1 **CU**	**Year 2** **CU**	**Year 3** **CU**	**Year 4** **CU**	**Year 5** **CU**
Principal balance	5,000,000	4,500,000	3,500,000	2,000,000	–
Interest payable	250,000	250,000	225,000	175,000	100,000
Total payments (principal and interest)	250,000	750,000	1,225,000	1,675,000	2,100,000
Present value of payments	227,272	619,835	920,360	1,144,048	1,303,935
Total present value of payments					4,215,450

Proceeds received	5,000,000
Less: Present value of outflows (fair value of loan on initial recognition)	4,215,450
Off-market portion of loan to be recognised as non-exchange revenue	784,550

Table 3: Calculation of Loan Balance and Interest Using the Effective Interest Method

	Year 1 **CU**	**Year 2** **CU**	**Year 3** **CU**	**Year 4** **CU**	**Year 5** **CU**
Principal	4,215,450	4,386,995	4,075,695	3,258,264	1,909,091
Interest accrual	421,545	438,700	407,569	325,827	190,909
Interest payments	(250,000)	(250,000)	(225,000)	(175,000)	(100,000)
Principal payments	-	(500,000)	(1,000,000)	(1,500,000)	(2,000,000)
Balance	4,386,995	4,075,695	3,258,264	1,909,091	–

Example 21—Payment of a Concessionary Loan (Principal Concession)[45]

IE156. The department of education makes low interest loans available to qualifying students with delayed repayment terms as a means of promoting post-secondary education.

IE157. The department advanced CU250 million to various students at the beginning of the financial year, with the following terms and conditions:

Principal to be repaid as follows:

Year 1 to 3: no principal repayments

Year 4: 30 per cent principal to be repaid

Year 5: 30 per cent principal to be repaid

Year 6: 30 per cent principal to be repaid

The remaining principal balance (10 per cent of CU250 million) outstanding at the end of year 6 is to be forgiven.

Interest is calculated at 11.5 per cent interest on the outstanding loan balance, and is to be paid annually in arrears. Assume the market rate of interest for a similar loan is 11.5 per cent.

[45] For simplicity, this example excludes any considerations in relation to calculating expected credit losses.

Scenario 1: Amortised Cost

IE158. After assessing the substance of the concessionary loan, the department of education classifies the financial asset in accordance with paragraphs 39–44. Based on the facts in the example, the department of education classifies the financial assets as measured at amortised cost.

IE159. The aggregated journal entries to account for the concessionary loans when measured at amortised cost are as follows:

1. On initial recognition, the entity recognises the following:

Dr	Loan	236,989,595	
Dr	Expense	13,010,405	
Cr	Bank		250,000,000

Recognition of the advance of the loans at fair value
Paragraph AG125(b) is considered in recognising an expense for the off-market portion of the loan deemed to be a non-exchange expense.

2. Year 1: The entity recognises the following

Dr	Loan	27,253,803	
Cr	Interest revenue		27,253,803

Interest accrual using the effective interest method (CU236,989,595 × 11.5 per cent)

Dr	Bank	28,750,000	
Cr	Loan		28,750,000

Interest payment of CU250m × 11.5 per cent

3. Year 2: The entity recognises the following:

Dr	Loan	27,081,741	
Cr	Interest revenue		27,081,741

Interest accrual using the effective interest method (CU235,493,398 × 11.5 per cent)

Dr	Bank	28,750,000	
Cr	Loan		28,750,000

Interest payment of CU250m × 11.5 per cent

4. Year 3: The entity recognises the following:

Dr	Loan	26,889,891	
Cr	Interest revenue		26,889,891

Interest accrual using the effective interest method (CU233,825,139 × 11.5 per cent)

Dr	Bank	28,750,000	
Cr	Loan		28,750,000

Interest payment of (CU250m × 11.5 per cent)

5. Year 4: The entity recognises the following:

Dr	Loan	26,675,979	
Cr	Interest revenue		26,675,979

Interest accrual using the effective interest method (CU231,965,030 × 11.5 per cent)

Dr	Bank	103,750,000	
Cr	Loan		103,750,000

Recognition of interest and principal received on outstanding balance (CU250m × 11.5 per cent + CU75m)

6. Year 5: The entity recognises the following:

Dr	Loan	17,812,466	
Cr	Interest revenue		17,812,466

Interest accrual using the effective interest method (CU154,891,009 × 11.5 per cent)

Dr	Bank	95,125,000	
Cr	Loan		95,125,000

Recognition of interest and principal received on outstanding balance (CU175m ×11.5 per cent + CU75m)

7. Year 6: The entity recognises the following:

Dr	Loan	8,921,525	
Cr	Interest revenue		8,921,525

Interest accrual using the effective interest method (CU77,578,475 × 11.5 per cent)

Dr	Bank	86,500,000	
Cr	Loan		86,500,000

Recognition of interest and principal received on outstanding balance (CU100m × 11.5 per cent + CU75m)

Scenario 2: Fair Value through Surplus/Deficit

IE160. In addition to the terms outlined in paragraph IE157, the loans provide the department of education the ability to call the instrument at any time for an amount that does not substantially reflect payment of outstanding principal and interest. After assessing the substance of the concessionary loans, the department of education determines the classification of the financial asset in accordance with paragraphs 39–44. Because the call feature in this example precludes the cash flows of this instrument from being solely payments of principal and interest, the department of education concludes the financial assets are classified at fair value through surplus/deficit.

IE161. The aggregated journal entries to account for the concessionary loans when classified at fair value through surplus/deficit are as follows:

1.	On initial recognition, the entity recognises the following:			
Dr		Loan	236,989,595	
Dr		Expense	13,010,405	
	Cr	Bank		250,000,000
Recognition of the advance of the loans at fair value				
Paragraph AG125(b) is considered in recognising an expense for the off-market portion of the loan deemed to be a non-exchange expense.				
2.	Year 1: The entity recognises the following			
Dr		Loan	27,253,803	
	Cr	Interest revenue		27,253,803
Interest accrual of CU236,989,595 × 11.5 per cent				
Dr		Bank	28,750,000	
	Cr	Loan		28,750,000
Interest payment of CU250m × 11.5 per cent				
3.	Year 2: The entity recognises the following:			
Dr		Loan	27,081,741	
	Cr	Interest revenue		27,081,741
Interest accrual of CU235,493,398 × 11.5 per cent				
Dr		Bank	28,750,000	
	Cr	Loan		28,750,000
Interest payment of CU250m × 11.5 per cent				
Dr		Fair value adjustment	2,766,221	
	Cr	Loan		2,766,221
Fair value adjustment (CU231,058,918[46] – (CU235,493,398 + CU27,081,741 – CU28,750,000))				
4.	Year 3: The entity recognises the following:			
Dr		Loan	26,571,776	
	Cr	Interest revenue		26,571,776
Interest accrual of CU231,058,918 × 11.5 per cent				
Dr		Bank	28,750,000	
	Cr	Loan		28,750,000
Interest payment of CU250m × 11.5 per cent				
Dr		Fair value adjustment	2,620,867	
	Cr	Loan		2,620,867
Fair value adjustment (CU226,259,827[47] – (CU231,058,918 + CU26,571,776 – CU28,750,000))				
5.	Year 4: The entity recognises the following:			
Dr		Loan	26,019,880	
	Cr	Interest revenue		26,019,880
Interest accrual of CU226,259,827 × 11.5 per cent				
Dr		Bank	103,750,000	
	Cr	Loan		103,750,000
Interest payment of CU250m × 11.5 per cent + CU75m principal repaid				
Dr		Loan	1,472,217	
	Cr	Fair value adjustment		1,472,217
Fair value adjustment (CU150,001,924[47] – (CU226,259,827 + CU26,019,880 – CU103,750,000))				

[46] See table 4 in this example for reference to fair values.

6. Year 5: The entity recognises the following:

Dr	Loan	17,250,221	
Cr	Interest revenue		17,250,221

Interest accrual of CU150,001,924 × 11.5 per cent

Dr	Bank	95,125,000	
Cr	Loan		95,125,000

Interest payment of CU175m × 11.5 per cent + CU75m principal repaid

Dr	Loan	3,750,048	
Cr	Fair value adjustment		3,750,048

Fair value adjustment (CU75,877,193[47] – (CU150,001,924 + CU17,250,221 – CU95,125,000))

7. Year 6: The entity recognises the following:

Dr	Loan	8,725,877	
Cr	Interest revenue		8,725,877

Interest accrual of CU75,877,193 × 11.5 per cent

Dr	Bank	86,500,000	
Cr	Loan		86,500,000

Interest payment of CU100m × 11.5 per cent + CU75m principal repaid

Dr	Loan	1,896,930	
Cr	Fair value adjustment		1,896,930

Fair value adjustment (CU0[47] – (CU75,877,193 + CU8,725,877 – CU86,500,000))

Calculations

Table 1: Amortisation Schedule (Using Contractual Repayments at 11.5 per cent Interest)

	Year 0 CU'000	Year 1 CU'000	Year 2 CU'000	Year 3 CU'000	Year 4 CU'000	Year 5 CU'000	Year 6 CU'000
Principal	250,000	250,000	250,000	250,000	250,000	175,000	100,000
Interest	–	28,750	28,750	28,750	28,750	20,125	11,500
Payments	–	(28,750)	(28,750)	(28,750)	(103,750)	(95,125)	(86,500)
Balance	**250,000**	**250,000**	**250,000**	**250,000**	**175,000**	**100,000**	**25,000**

Table 2: Discounting Contractual Cash Flows (Based on a Market Rate of 11.5 per cent)

	Year 1 CU	Year 2 CU	Year 3 CU	Year 4 CU	Year 5 CU	Year 6 CU
Principal balance	250,000,000	250,000,000	250,000,000	175,000,000	100,000,000	25,000,000
Interest receivable	28,750,000	28,750,000	28,750,000	28,750,000	20,125,000	11,500,000
Total receipts (principal and interest)	28,750,000	28,750,000	28,750,000	103,750,000	95,125,000	86,500,000
Present value of cash flows	25,784,753	23,125,339	20,740,215	67,125,670	55,197,618	45,016,000
Total present value of cash flows						236,989,595
Proceeds paid						250,000,000
Less: Present value of inflows (fair value of loan on initial recognition)						236,989,595
Off-market portion of loan to be recognised as expense						13,010,405

Table 3: Calculation of Loan Balance and Interest Using the Effective Interest Method

	Year 1 CU	Year 2 CU	Year 3 CU	Year 4 CU	Year 5 CU	Year 6 CU
Principal	236,989,595	235,493,398	233,825,139	231,965,030	154,891,009	77,578,475
Interest accrual	27,253,803	27,081,741	26,889,891	26,675,979	17,812,466	8,921,525
Interest	(28,750,000)	(28,750,000)	(28,750,000)	(28,750,000)	(20,125,000)	(11,500,000)
Principal receipts	-	-	-	(75,000,000)	(75,000,000)	(75,000,000)
Balance	235,493,398	233,825,139	231,965,030	154,891,009	77,578,475	–

Table 4: Fair Value of Loan

	Year 1 CU	Year 2 CU	Year 3 CU	Year 4 CU	Year 5 CU	Year 6 CU
Fair value	236,989,595	235,493,398	231,058,918	226,259,827	150,001,924	75,877,193
Market interest rate (beginning of year)	11.5 per cent	11.5 per cent	12 per cent	13 per cent	14 per cent	14 per cent
Market interest rate (end of year)	11.5 per cent	12 per cent	13 per cent	14 per cent	14 per cent	14 per cent
Interest accrual (11.5 per cent)	27,253,803	27,081,741	26,571,776	26,019,880	17,250,221	8,725,877
Interest	(28,750,000)	(28,750,000)	(28,750,000)	(28,750,000)	(20,125,000)	(11,500,000)
Principal receipts	-	-	-	(75,000,000)	(75,000,000)	(75,000,000)
Fair value adjustment	-	(2,766,221)	(2,620,867)	1,472,217	3,750,048	1,896,930
Balance	235,493,398	231,058,918	226,259,827	150,001,924	75,877,193	–

Example 22—Payment of a Concessionary Loan (Loan Commitment)

IE162. Prior to the beginning of every wheat agricultural season, the department of agriculture makes low-interest loans available to qualifying farmers as a means of promoting the cultivation of wheat within the jurisdiction. These loans are available on demand by individual farmers at any time during the planting season and must be repaid prior to the subsequent planting season.

IE163. The department makes available CU100 million to various farmers at the beginning of the harvest season in 20x1. By the end of the harvest season the department has distributed all CU100 million with the following terms and conditions:

- Principal is to be repaid prior to the next harvest season.
- No interest is charged on the outstanding loan balance. Assume the market rate of interest for similar loans is 1.5 per cent.

At the origination of the loan commitments, there is no indication that the instruments are credit-impaired.

Scenario 1: No expected credit losses identified during the loan commitment period

IE164. As the department of agriculture has committed to issue below-market-rate loans, the commitments are accounted for in accordance with paragraphs 45(d) and 57. The aggregated journal entries to initially account for the loan commitments are as follows:

1. On initial recognition, the entity recognises the following:

Dr		Expense	1,477,833	
	Cr	Loan commitment liability		1,477,833

Recognition of commitments to issue loans at below-market rates
The loan commitments are initially measured at fair value in accordance with paragraph 57.

IE165. No further entries are required during the commitment period. This is a result of the department of agriculture electing not to charge a commitment fee, resulting in no revenue to recognise associated with the loan commitments, and the department identifying no credit losses during the commitment period.

IE166. When the concessionary loans are granted, and the loan commitments are satisfied, the substance of the concessionary loans is assessed. The department of agriculture classifies the financial assets in accordance with paragraphs 39–44. Based on the facts in the example, the department of agriculture classifies the financial assets as measured at amortised cost.

IE167. The aggregated journal entries to account for the concessionary loans are as follows:

2. On initial recognition, the entity recognises the following:

Dr	Loan	98,522,167	
Dr	Loan commitment liability	1,477,833	
Cr	Cash		100,000,000

Recognition of the advance of the loans at fair value
Paragraph AG125(b) is considered in recognising an expense for the off-market portion of the loan deemed to be a non-exchange expense. However, as an expense was previously recognised as part of the loan commitment, no further expense is required.

3. Interest is recognised as follows:

Dr	Loan	1,477,833	
Cr	Interest revenue		1,477,833

Interest accrual using the effective interest method (CU98,522,167× 1.5 per cent)

4. Loan repayments are recognised as follows:

Dr	Cash	100,000,000	
Cr	Loan		100,000,000

Department of agriculture collects principal repayments of CU100 million

Scenario 2: Evidence of credit impairment identified during the loan commitment period

IE168. As the department of agriculture has committed to issue below-market-rate loans, the commitments are accounted for in accordance with paragraphs 45(d) and 57. The aggregated journal entries to initially account for the loan commitments are as follows:

1. On initial recognition, the entity recognises the following:

Dr	Expense	1,477,833	
Cr	Loan commitment liability		1,477,833

Recognition of commitments to issue loans at below-market rates
The loan commitments are initially measured at fair value in accordance with paragraph 57.

IE169. During the loan commitment period, the department of agriculture noted the yield from the current season's wheat harvest was expected to be lower than initially projected. Using the most recent information available, the department of agriculture makes the following estimates:

- The portfolio of loans has a lifetime probability of default of 5 per cent; and
- The loss given default is 35 per cent, and would occur when the principal is repaid.

2. The impairment is recognised as follows:

Dr	Impairment expense	1,724,137	
Dr	Loan commitment liability	1,477,833	
Cr	Loss allowance		3,201,970

Recognition of impairment expense of CU 1.724 million
The impairment expense is CU1.724 million, which is calculated by multiplying the amount of cash flows receivable (CU 100 million) by the probability of default (5 per cent) and by the loss given default (35 per cent), and discounting at the effective interest rate for one year (1.5 per cent).

IE170. As the concessionary loans are provided, and the loan commitments are satisfied, the substance of the concessionary loans is assessed. The department of agriculture classifies the financial assets in accordance with paragraphs 39–44. Based on the facts in the example, the department of agriculture classifies the financial assets as measured at amortised cost.

IE171. The aggregated journal entries to account for the concessionary loans are as follows:

3. On initial recognition, the entity recognises the following:

Dr	Loan	96,798,030	
Dr	Loss allowance-	3,201,970	
Cr	Cash		100,000,000

Recognition of the advance of the loans at fair value
Paragraph AG125(b) is considered in recognising an expense for the off-market portion of the concessionary originated credit-impaired loan. However, as an expense was previously recognised as part of the loan commitment, no further expense is required.

4. Interest is recognised as follows:

Dr	Loan	1,451,970	
Cr	Interest revenue		1,451,970

Interest accrual using the effective interest method (CU96,798,030 × 1.5 per cent)

IE172. Prior to the loan maturing, the harvest was stronger than projected during the commitment period. Credit losses on the principal balance are expected to be CU 500,000.

5. The impairment gain is recognised as follows:

Dr	Loan	1,250,000	
Cr	Impairment gain		1,250,000

Recognition of the impairment gain of CU1.25 million
Reduction of CU1.25 million is required in order to recognise total expected credit losses of CU500,000 (CU99,500,000 – CU96,798,030 – CU1,451,970).

6. Loan repayments are recognised as follows:

Dr	Cash	99,500,000	
Cr	Loan		99,500,000

Department of agriculture collects principal repayments of CU99.5 million

Calculations

Table 1: Amortisation Schedule (Using Contractual Repayments at 1.5 per cent Interest)

	Year 0	**Year 1**
Principal	100,000,000	100,000,000
Interest	–	-
Payments	–	100,000,000
Balance	**100,000,000**	**-**

Table 2: Discounting Contractual Cash Flows (Based on a Market Rate of 1.5 Per cent)

	Year 1 CU
Principal balance	100,000,000
Interest payable	-
Total payments (principal and interest)	100,000,000
Present value of payments	98,522,167
Total present value of payments	98,522,167
Proceeds paid	100,000,000
Less: Present value of outflows (fair value of loan on initial recognition)	98,522,167
Off-market portion of loan to be recognised as expense	1,477,833

Table 3: Calculation of Loan Balance and Interest Using the Effective Interest Method

	Year 1 CU
Principal	98,522,167
Interest accrual	1,477,833
Interest	-
Principal payments	100,000,000
Balance	-

Financial Guarantee (paragraphs AG131–AG136)

Example 23—Financial Guarantee Contract Provided at Nominal Consideration

IE173. Entity C is a major motor vehicle manufacturer in Jurisdiction A. On January 1, 20X1 Government A (the issuer) enters into a financial guarantee contract with Entity B (the holder) to reimburse Entity B against the financial effects of default by Entity C (the debtor) for a 5 year loan of 50 million Currency Units (CUs) repayable in two equal instalments of CU25 million in 20X3 and 20X5. Entity C provides nominal consideration of CU5,000 to Government A. At initial recognition, Government A measures the financial guarantee contract at fair value. Applying a valuation technique, Government A determines the fair value of the financial guarantee contract to be CU5,000,000.

IE174. On December 31, 20X1, having reviewed the financial position and performance of Entity C and having evaluated forward looking information including expected automotive industry trends, Government A determines there has been no significant increase in credit risk since initial recognition. In applying the measurement requirements of paragraph 45(c), Government A measures the financial guarantee contract at the higher of:

(a) The amount of the loss allowance calculated in accordance with this standard; and

(b) The amount initially recognised, less the cumulative amount of revenue recognised.

Government A measures the loss allowance at an amount equal to the 12 month expected credit losses. Government A calculates the amount of loss allowance to be less than the amount initially recognised. Government A therefore does not recognise an additional liability in its statement of financial position. Government A makes the disclosures relating to fair value and credit risk in PBE IPSAS 30 in respect of the financial guarantee contract. In its statement of comprehensive revenue and expense Government A recognises revenue of CU1,000,000 in respect of the initial fair value of the instrument (total consideration of CU5,000,000 / 5 years).

IE175. In 20X2 there has been a downturn in the motor manufacturing sector affecting Entity C. Although it has met its obligations for interest payments, Entity C is seeking bankruptcy protection and is expected to default on its first repayment of principal. Negotiations are advanced with a potential acquirer (Entity D), which will restructure Entity C. Entity D has indicated that it will assume responsibility for the final instalment of the loan with Entity B, but not the initial instalment. Government A determines there has been a significant increase in credit risk since initial recognition of the financial guarantee contract and measures the loss allowance associated with the financial guarantee contract at an amount equal to the lifetime expected credit losses. Government A calculates the lifetime expected credit losses to be CU25.5 million and recognises an expense for, and increases its liability by, CU22.5 million (after the sale to Entity D, the Government has an expected loss of 25 million CUs on the first instalment and CU500,000 on the final instalment, for a total liability of CU25.5 million. The current balance of the financial guarantee of CU3 million is required to be increased by CU22.5 million).

IE176. The journal entries at initial acquisition and at the reporting dates are as follows:

1. On initial recognition, the entity recognises the following:

Dr		Bank	5,000	
Dr		Expense	4,995,000	
	Cr	Financial guarantee contract		5,000,000

2. Year 1: The entity recognises the following

Dr		Financial guarantee contract	1,000,000	
	Cr	Revenue		1,000,000

Revenue of CU5,000,000 is recognised over a 5 year period

3. Year 2: The entity recognises the following:

Dr		Financial guarantee contract	1,000,000	
	Cr	Revenue		1,000,000

Revenue of CU5,000,000 is recognised over a 5 year period

Dr		Expense	22,500,000	
	Cr	Financial guarantee contract		22,500,000

Lifetime expected credit losses of CU25.5 million less CU3,000,000 recognised as a liability

Fair Value Measurement Considerations (paragraphs 66–68)

IE177. Illustrative examples 23–26 demonstrate different valuation techniques for valuing unquoted equity instruments. When selecting an appropriate valuation technique, professional judgement is exercised in considering the requirements in paragraphs AG149–AG154.

Example 24—Valuation of Unquoted Equity Instruments (Transaction Price Paid for an Identical or Similar Instrument)

IE178. In 20X0, a Sovereign Wealth Fund bought ten equity shares of Entity D, a private company, representing 10 per cent of the outstanding voting shares of Entity D, for CU1,000. The Sovereign Wealth Fund prepares annual financial statements and is required to measure the fair value of its non-controlling equity interest in Entity D as at December 31, 20X2 (i.e., the measurement date).

IE179. During December of 20X2, Entity D raised funds by issuing new equity capital (ten shares for CU1,200) to other investors. The Sovereign Wealth Fund concludes that the transaction price of the new equity capital issue for CU1,200 represents fair value at the date those shares were issued.

IE180. Both the Sovereign Wealth Fund and the other investors in Entity D have shares with the same rights and conditions. Between the new equity capital issue to other investors and the measurement date, there have been no significant external or internal changes in the environment in which Entity D operates. As a result, the Sovereign Wealth Fund concludes that CU1,200 is the amount that is most representative of the fair value of its non-controlling equity interest in Entity D at the measurement date.

Analysis

IE181. When an investor has recently made an investment in an instrument that is identical to the unquoted equity instrument being valued, the transaction price can be a reasonable starting point for measuring the fair value of the unquoted equity instrument at the measurement date, if that transaction price represented the fair value of the instrument at initial recognition. An investor must, however, use all information about the performance and operations of an investee that becomes reasonably available to the investor after the date of initial recognition up to the measurement date, because such information might have an effect on the fair value of the unquoted equity instrument of the investee at the measurement date.

Example 25—Valuation of Unquoted Equity Instruments (Discounted Cash Flow)

IE182. As part of an initiative to encourage the use of renewable energy, Government A has a 5 per cent non-controlling equity interest in Entity R, a private company developing highly efficient solar panels in Government A's jurisdiction. Government A derives Entity R's indicated fair value of equity by deducting the fair value of debt (in this case assumed to be CU240 million) from the enterprise value of CU1,121.8 million as shown in the table below. Government A has concluded that there are no relevant non-operating items that need to be adjusted from Entity R's expected free cash (FCF).

IE183. Entity R's value was computed by discounting the expected free cash flows (i.e., post-tax cash flows before interest expense and debt movements, using an unlevered tax rate) by an assumed weighted average cost of capital (WACC) of 8.9 per cent. The WACC computation included the following variables: cost of equity capital of 10.9 per cent, cost of debt capital of 5.7 per cent, effective income tax rate of 30 per cent, debt to total capital ratio of 28.6 per cent and equity to total capital ratio of 71.4 per cent.

	Year 0 CU'000	Year 1 CU'000	Year 2 CU'000	Year 3 CU'000	Year 4 CU'000	Year 5 CU'000
FCF[47]	-	100	100	100	100	100
Terminal value[48]						1,121.8
DCF Method using enterprise value less fair value of debt						
Discount factors[49]		0.9182	0.8430	0.7740	0.7107	0.6525
Present value of FCF and terminal value[50]		91.8	84.3	77.4	71.1	797.2
Enterprise value	1,121.8					
Less fair value of debt	(240.0)					
Indicated fair value of equity	**881.8**					

IE184. This example assumes that all unquoted equity instruments of Entity R have the same features and give the holders the same rights. However, Government A considers that the indicated fair value of equity obtained above (CU881.8 million) must be further adjusted to consider:

- a non-controlling interest discount because Government A's interest in Entity R is a non-controlling equity interest and Government A has concluded that there is a benefit associated with control. For the purposes of this example, it has been assumed that the non-controlling interest discount is CU8.00 million;[51] and
- a discount for the lack of liquidity, because Government A's interest in Entity R is unquoted. For the purposes of this example, it has been assumed that the discount for the lack of liquidity amounts to CU4.09 million.[51]

IE185. As a result, Government A concludes that CU32 million is the price that is most representative of the fair value of its 5 per cent non-controlling equity interest in Entity R at the measurement date, as shown below:

	CU'000
Indicated fair value of equity x 5 per cent (i.e., CU881.8 x 5 per cent)	44.09
Non-controlling interest discount	(8.00)
Discount for lack of liquidity	(4.09)
Fair value of 5 per cent non-controlling equity interest	**32.00**

Example 26—Valuation of Unquoted Equity Instruments (Constant Growth with Limited Information)

IE186. Entity S is a private company. Public Investment Fund T has a 10 per cent non-controlling equity interest in Entity S. Entity S's management has prepared a two-year budget. However, Entity S's management shared with the manager of Public Pension Plan T materials from its annual Board meetings, at which management discussed the assumptions to back up the expected growth plan for the next five years.

IE187. On the basis of the information obtained from the Board meeting, Public Investment Fund T has extrapolated the two-year budget by reference to the basic growth assumptions discussed in the Board meeting and has performed a discounted cash flow calculation.

47 FCF represent cash flows before interest expense and debt movements. The tax charge has been computed considering no deduction for interest expense.

48 The terminal value has been computed assuming the yearly cash flows amounting to CU100 million would grow in perpetuity at a rate of zero (i.e., assuming that the impact of inflation on future cash flows is expected to be offset by market shrinkage).

49 The discount factors have been computed using the formula: 1/(1 + WACC) ^ year. This formula, however, implies that the cash flows are expected to be received at the end of each period. Sometimes it might be more appropriate to assume that cash flows are received more or less evenly throughout the year (mid-year discounting convention). Using the mid-year discounting convention, the discount factor for year 'n' would have been computed as follows: 1/(1 + WACC) ^ (n – 0.5).

50 The present value amounts have been computed by multiplying the FCF and terminal value by the corresponding discount factors.

51 The process shown above is not the only possible method that a public benefit entity could apply to measure the fair value of its non-controlling equity interest. As a result, the adjustments above should not be considered to be a comprehensive list of all applicable adjustments. The necessary adjustments will depend on the specific facts and circumstances. In addition, the amounts of the adjustments above are not supported by detailed calculations. They have been included for illustrative purposes only.

IE188. On the basis of Entity S's management's two-year detailed budget, sales and EBIT would reach CU200 and CU50, respectively, in 20X3. Public Investment Fund T understands that Entity S's management expects sales to achieve further growth of 5 per cent per annum until 20X8 with the same EBIT margin (as a percentage of sales) as in 20X3. Consequently, Public Investment Fund T projects the EBIT of Entity S as follows:[52]

	Year 1 CU'000	Year 2 CU'000	Year 3 CU'000	Year 4 CU'000	Year 5 CU'000	Year 6 CU'000	Year 7 CU'000
Sales	150	200	210	221	232	243	255
EBIT margin	23%	25%	25%	25%	25%	25%	25%
EBIT	**35**	**50**	**53**	**55**	**58**	**61**	**64**

IE189. Public Investment Fund T is also aware that the management of Entity S expects the entity to reach a stable growth stage by 20X8. To calculate the terminal value, using the constant growth discount model, Public Investment Fund T assumes a long-term terminal growth rate of 2 per cent on the basis of the long-term outlook of Entity S, its industry and the economy in the country where Entity S operates. If Entity S has not reached the stable growth stage by the end of the projection period, Public Investment Fund T would need to extend the projection period until the stable growth stage is reached and calculate the terminal value at that point.[53]

IE190. Finally, Public Investment Fund T cross-checks this valuation by comparing Entity S's implied multiples to those of its comparable company peers.[54]

Example 27—Valuation of Unquoted Equity Instruments (Adjusted Net Assets)

IE191. State Government A has a 10 per cent non-controlling equity interest in Entity V, a private company. There is no controlling shareholder for Entity V, which is a payroll services provider for its investors, including State Government A. Entity V's transactions, and therefore service fees, depend on the total number of employees of its investors (which are all the State Governments of Jurisdiction Z) and, as a result, Entity V does not have its own growth strategy. Entity V has a very low profit margin and it does not have comparable public company peers.

IE192. State Government A needs to measure the fair value of its non-controlling equity interest in Entity V as of December 31, 20X1 (i.e., the measurement date). State Government A has Entity V's latest statement of financial position, which is dated September 30, 20X1.

IE193. The following are the adjustments performed by State Government A to the latest statement of financial position of Entity V:

- Entity V's major asset is an office building that was acquired when Entity V was founded 25 years ago. The fair value of the building was measured by a valuation specialist at CU2,500 at the measurement date. This value compares to a book value of CU1,000.
- During the three-month period from September 30, 20X1 to the measurement date, the fair value of Entity V's investments in public companies changed from CU500 to CU600.
- State Government A observes that Entity V measures its current assets and current liabilities at fair value. The volume of operations of Entity V is so flat that the investor estimates that the amounts of the current assets and current liabilities shown in Entity V's statement of financial position as of September 30, 20X1 are most representative of their fair value at the measurement

[52] To derive Entity S's FCF for use in the discounted cash flow method, Public Investment Fund T used Entity S's two-year budget and its understanding of the investee's asset and capital structures, reinvestment requirements and working capital needs.

[53] This example illustrates a two-stage model in which the first stage is delineated by a finite number of periods (20X2–20X8) and after this first stage the example assumes a period of constant growth for which Public Investment Fund T calculates a terminal value for Entity S. In other cases an investor might conclude that a multiple-stage model rather than a two-stage model would be more appropriate. A multiple-stage model would generally have a period after the discrete projection period in which growth might be phased down over a number of years before the constant growth period for which a terminal value can be estimated.

[54] This example assumes that the fair value conclusion would have included any necessary adjustments (for example, non-controlling interest discount, discount for the lack of liquidity etc.) that market participants would incorporate when pricing the equity instruments at the measurement date.

date, with the exception of an amount of CU50 included in Entity V's trade receivables that became unrecoverable after September 30, 20X1.

- On the basis of Entity V's management model and profitability, State Government A estimates that unrecognised intangible assets would not be material.
- State Government A does not expect that Entity V's cash flows for the quarter ended December 31, 20X1 are material.
- State Government A does not expect any major sales of assets from Entity V. As a result, it concludes that there are no material tax adjustments that need to be considered when valuing Entity V.

Entity V – Statement of financial position (CU)

	Sept 30, 20X1	**Adjustments**	**Estimated Dec 31, 20X1**
ASSETS			
Non-current assets			
Property, plant and equipment	2,000	1,500	3,500
Investments in equity instruments	500	100	600
	2,500	1,600	4,100
Current assets			
Trade receivables	500	(50)	450
Cash and cash equivalents	500	-	500
	1,000	(50)	950
Total Assets	**3,500**	**1,550**	**5,050**
NET ASSETS/EQUITY AND LIABILITIES			
Total net assets/equity	2,500	1,550	4,050
Current liabilities	1,000	0	1,000
Total net assets/equity and liabilities	**3,500**	**1,550**	**5,050**

IE194. Before considering any adjustments (for example, discount for the lack of liquidity, non-controlling interest discount), the indicated fair value of State Government A's 10 per cent non-controlling equity interest in Entity V is CU405 (10 per cent x CU4,050 = CU405). For the purpose of this example, it has been assumed that the discount for the lack of liquidity amounts to CU40 and that the non-controlling interest discount amounts to CU80.

IE195. On the basis of the facts and circumstances described above, State Government A concludes that the price that is most representative of fair value for its 10 per cent non-controlling equity interest in Entity V is CU285 at the measurement date (CU405 – (CU40 – CU85 = CU285).[55]

Example 28—Valuation of Unquoted Equity Instruments with Non-Exchange Component

IE196. National Government A purchased 1,000 shares of International Investment Bank B on 1 July 20X6 for CU5,000, or CU5 per share. Because National Government A is a non-controlling shareholder, it does not receive the Bank's budgets or cash flow forecasts. National Government A prepares annual financial statements and is measuring the fair value of its non-controlling equity interest in the International Investment Bank on December 31, 20X6 (i.e., the measurement date).

IE197. The amount paid for the unquoted equity instruments (CU5,000) in July 20X6 is a reasonable starting point for measuring the fair value of the investor's non-controlling equity interest in International Investment Bank B at the measurement date. However, National Government A is required to assess whether the amount paid needs to be adjusted if there is evidence that other factors exist or if other evidence indicates that the transaction price is not representative of fair value at the measurement date. For example, in some circumstances a public benefit entity may transfer consideration in excess of the fair value of the shares acquired, to provide a subsidy to the recipient. In these circumstances, National Government A adjusts the transaction price accordingly and recognises an expense for the concessionary

[55] The process shown above is not the only possible method that a public benefit entity could apply to measure the fair value of its non-controlling equity interest. As a result, the adjustments above should not be considered to be a comprehensive list of all applicable adjustments. The necessary adjustments will depend on the specific facts and circumstances. In addition, the amounts of the adjustments above are not supported by detailed calculations. They have been included for illustrative purposes only.

portion of the consideration because the transaction includes a payment for the equity instrument and subsidy.

Example 29—Valuation of Unquoted Equity Instruments Arising from a Non-Exchange Transaction

IE198. On January 1, 20X1, National Government A transfers CU1000 to International Development Bank B. In exchange, Bank B issues 100 common shares with a par value of CU8. In transferring the CU1000, National Government A granted a concession of CU200, as evidenced in the transaction documentation.

IE199. When accounting for the transaction, National Government A identifies two components embedded in the transfer of CU1000. The first component is a non-exchange expense of CU200. National Government A applies the guidance in paragraphs AG128–AG130 when accounting for this component.

IE200. The second component is the 100 common shares in Bank B. PBE IPSAS 41 requires, at initial recognition, financial instruments be measured at fair value plus or minus, in the case of a financial asset or financial liability not at fair value through surplus or deficit, directly attributable transaction costs.

IE201. As the best evidence of fair value at initial recognition is normally the transaction price, National Government A determines the transaction price of CU800, as evidenced in the transaction document (100 common shares x par value of CU8/share), is the appropriate value at initial recognition.

IE202. In addition to the transaction documentation, National Government concludes CU8 per share is the fair value of each share based on other similar transactions Bank B had with other national governments. In each transaction, Bank B issued common shares for CU8.

Example 30—Valuation of Debt Obligations: Quoted Price

IE203. On January 1, 20X1, State Government B issues at par a CU2 million BBB-rated exchange-traded five-year fixed rate debt instrument with an annual 10 per cent coupon. State Government B designated this financial liability as at fair value through surplus or deficit.

IE204. On December 31, 20X1, the instrument is trading as an asset in an active market at CU929 per CU1,000 of par value after payment of accrued interest. State Government B uses the quoted price of the asset in an active market as its initial input into the fair value measurement of its liability (CU929 × [CU2 million ÷ CU1,000] = CU1,858,000).

IE205. In determining whether the quoted price of the asset in an active market represents the fair value of the liability, State Government B evaluates whether the quoted price of the asset includes the effect of factors not applicable to the fair value measurement of a liability. State Government B determines that no adjustments are required to the quoted price of the asset. Accordingly, State Government B concludes that the fair value of its debt instrument at December 31, 20X1, is CU1,858,000. State Government B categorises and discloses the fair value measurement of its debt instrument within Level 1 of the fair value hierarchy in accordance with PBE IPSAS 30.

Example 31—Valuation of Debt Obligations: Present Value Technique

IE206. On January 1, 20X1, National Government C issues at par in a private placement a CU2 million BBB-rated five-year fixed rate debt instrument with an annual 10 per cent coupon. National Government C designated this financial liability as at fair value through surplus or deficit.

IE207. At December 31, 20X1, National Government C still carries a BBB credit rating. Market conditions, including available interest rates, credit spreads for a BBB-quality credit rating and liquidity, remain unchanged from the date the debt instrument was issued. However, National Government C's credit spread has deteriorated by 50 basis points because of a change in its risk of non-performance. After taking into account all market conditions, National Government C concludes that if it was to issue the instrument at the measurement date, the instrument would bear a rate of interest of 10.5 per cent or National Government C would receive less than par in proceeds from the issue of the instrument.

IE208. For the purpose of this example, the fair value of National Government C's liability is calculated using a present value technique. National Government C concludes that a market participant would use all the following inputs when estimating the price the market participant would expect to receive to assume National Government C's obligation:

(a) the terms of the debt instrument, including all the following:

(i) coupon of 10 per cent;

(ii) principal amount of CU2 million; and

(iii) term of four years.

(b) the market rate of interest of 10.5 per cent (which includes a change of 50 basis points in the risk of non-performance from the date of issue).

IE209. On the basis of its present value technique, National Government C concludes that the fair value of its liability at December 31, 20X1 is CU1,968,641.

IE210. Entity C does not include any additional input into its present value technique for risk or profit that a market participant might require for compensation for assuming the liability. Because National Government C's obligation is a financial liability, National Government C concludes that the interest rate already captures the risk or profit that a market participant would require as compensation for assuming the liability. Furthermore, National Government C does not adjust its present value technique for the existence of a restriction preventing it from transferring the liability.

Classification of Financial Assets (paragraphs 39–44)

Example 32—Capital Subscriptions Held with Redemption Features

IE211. In order to participate and support the activities of International Development Bank A, Federal Government B invests and acquires a fixed number of subscription rights in International Development Bank A, based on Government B's proportional share of global Gross Domestic Product. Each subscription right costs CU1,000, provides Government B with the right to put the subscription rights back to Bank A in exchange for the initial amount invested (i.e., CU1,000 per subscription right). International Development Bank A has no obligation to deliver dividends on the subscription rights.

IE212. Government B is evaluating the appropriate classification of the financial asset based on the terms of the subscription rights.

IE213. In determining the classification of the financial asset, Government B concludes the subscription rights do not meet the definition of an equity instrument as defined in PBE IPSAS 28 *Financial Instruments: Presentation*.[56] As a result, Government B concludes the election available in paragraph 43 to measure an equity instrument at fair value through other comprehensive revenue and expense is not available.

IE214. Furthermore, as the contractual terms of the subscription rights fail to give rise on specified dates to cash flows solely for payments of principal and interest, the subscription rights cannot be classified as a debt instrument measured at amortised cost or fair value through other comprehensive revenue and expense. Government B concludes puttable subscription rights are required to be classified at fair value through surplus or deficit.

Effective Interest Method (paragraphs 69–70)

Example 33—Measuring the Effective Interest Rate of a Bond Issued at a Discount with Transaction Costs

IE215. State Government A issues a 3-year bond with a face value of CU500,000. The instrument carries a fixed yield of 4 per cent, with interest payments paid annually. The bond was issued at a discount of 2 per cent and State Government A was required to pay the bond underwriters a fee equal to CU12,000 on the transaction date.

IE216. In determining the amortised cost of the instrument, State Government A must calculate the effective interest rate. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the instrument to the gross carrying amount of the instrument.

[56] Based on guidance in paragraphs 15, 16, 17 and 18 of PBE IPSAS 28 it is possible the puttable subscription rights meet the requirements to be classified as an equity instrument from the Bank's perspective. However, instruments meeting the provisions of paragraphs 15, 16, 17 and 18 of PBE IPSAS 28 do not meet the definition of an equity instrument in PBE IPSAS 28.

IE217. Assuming there are no expectations of prepayment, extension or other call options, the estimated future cash flows are CU20,000 per annum in interest payments (CU20,000 = CU500,000 x 4 per cent), with an additional CU500,000 principal payment made at maturity.

IE218. The gross carrying amount of the bond on the transaction date is calculated based on the net proceeds received by State Government A. Since the bond was issued at a discount, before transaction costs, State Government A received CU490,000 (CU500,000 x (100 per cent – 2 per cent)). Taking transaction costs into account, the next proceeds on issue were CU478,000 (CU490,000 – CU12,000).

Year	**(a)** Cash inflows	**(b)** Cash outflows (transaction costs and interest)	**(c)** Cash outflows (principal)	**(d = a – b – c)** Net cash flows
Year 1 (beginning)	500,000	12,000	10,000	478,000
Year 1 (end)	-	20,000	-	(20,000)
Year 2	-	20,000	-	(20,000)
Year 3	-	20,000	-	(20,000)
Year 4	-	20,000	-	(20,000)
Year 5	-	20,000	500,000	(520,000)

IE219. The effective interest rate of the bond is calculated by determining the rate that exactly discounts the estimated cash flows of CU20,000 per annum, plus the principal repayment at maturity, to the gross amount of CU478,000. Essentially, the effective interest rate determines the rate of interest incurred based on the net proceeds received by State Government A.

IE220. In this example, the effective interest rate is 5.02 per cent. This is appropriate as the bond yield was stated to be 4 per cent on a principal amount of CU500,000. However, in substance, State Government A only receives CU478,000 and continues to make annual interest payments of CU20,000. As such, as the transaction costs and discount increase, the more the effective interest rate will diverge from the contractual rate.

Effective interest rate = 5.02				
Year	**(a)** Opening balance	**(b)** Interest expense	**(c)** Interest/principal payment	**(d = a + b – c)** Ending balance
Year 1	478,000	23,980	20,000	481,980
Year 2	481,980	24,180	20,000	486,160
Year 3	486,160	24,389	20,000	490,549
Year 4	490,549	24,610	20,000	495,159
Year 5	495,159	24,841	520,000	-

IMPLEMENTATION GUIDANCE

CONTENTS

Implementation Guidance

This guidance accompanies, but is not part of, PBE IPSAS 41.

Section A Scope

A.1 Practice of Settling Net: Forward Contract to Purchase a Commodity

Entity XYZ enters into a fixed price forward contract to purchase 1 million barrels of oil in accordance with its expected usage requirements. The contract permits XYZ to take physical delivery of the oil at the end of twelve months or to pay or receive a net settlement in cash, based on the change in fair value of oil. Is the contract accounted for as a derivative?

While such a contract meets the definition of a derivative, it is not necessarily accounted for as a derivative. The contract is a derivative instrument because there is no initial net investment, the contract is based on the price of oil, and it is to be settled at a future date. However, if XYZ intends to settle the contract by taking delivery and has no history for similar contracts of settling net in cash or of taking delivery of the oil and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin, the contract is not accounted for as a derivative under PBE IPSAS 41 *Financial Instruments*. Instead, it is accounted for as an executory contract (unless the entity irrevocably designates it as measured at fair value through surplus or deficit in accordance with paragraph 6 of PBE IPSAS 41).

A.2 Option to Put a Non-Financial Asset

Entity XYZ owns an office building. XYZ enters into a put option with an investor that permits XYZ to put the building to the investor for CU150 million. The current value of the building is CU175 million.[57] **The option expires in five years. The option, if exercised, may be settled through physical delivery or net cash, at XYZ's option. How do both XYZ and the investor account for the option?**

XYZ's accounting depends on XYZ's intention and past practice for settlement. Although the contract meets the definition of a derivative, XYZ does not account for it as a derivative if XYZ intends to settle the contract by delivering the building if XYZ exercises its option and there is no past practice of settling net (paragraph 5 of PBE IPSAS 41; but see also paragraph 6 of PBE IPSAS 41).

The investor, however, cannot conclude that the option was entered into to meet the investor's expected purchase, sale or usage requirements because the investor does not have the ability to require delivery (PBE IPSAS 41, paragraph 8). In addition, the option may be settled net in cash. Therefore, the investor has to account for the contract as a derivative. Regardless of past practices, the investor's intention does not affect whether settlement is by delivery or in cash. The investor has written an option, and a written option in which the holder has a choice of physical settlement or net cash settlement can never satisfy the normal delivery requirement for the exemption from PBE IPSAS 41 because the option writer does not have the ability to require delivery.

However, if the contract were a forward contract instead of an option, and if the contract required physical delivery and the reporting entity had no past practice of settling net in cash or of taking delivery of the building and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin, the contract would not be accounted for as a derivative. (But see also paragraph 6 of PBE IPSAS 41).

Section B Definitions

B.1 Definition of a Financial Instrument: Gold Bullion

Is gold bullion a financial instrument (like cash) or is it a commodity?

It is a commodity. Although bullion is highly liquid, there is no contractual right to receive cash or another financial asset inherent in bullion.

[57] In this guidance, monetary amounts are denominated in 'currency units' (CU).

B.2 Definition of a Derivative: Examples of Derivatives and Underlyings

What are examples of common derivative contracts and the identified underlying?

PBE IPSAS 41 defines a derivative as follows:

A derivative is a financial instrument or other contract within the scope of this Standard with all three of the following characteristics.

(a) **Its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying').**

(b) **It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.**

(c) **It is settled at a future date.**

Type of contract	**Main pricing-settlement variable (underlying variable)**
Interest rate swap	Interest rates
Currency swap (foreign exchange swap)	Currency rates
Commodity swap	Commodity prices
Equity swap	Equity prices (equity instrument of another entity)
Credit swap	Credit rating, credit index or credit price
Total return swap	Total fair value of the reference asset and interest rates
Purchased or written treasury bond option (call or put)	Interest rates
Purchased or written currency option (call or put)	Currency rates
Purchased or written commodity option (call or put)	Commodity prices
Purchased or written stock option (call or put)	Equity prices (equity instrument of another entity)
Interest rate futures linked to government debt (treasury futures)	Interest rates
Currency futures	Currency rates
Commodity futures	Commodity prices
Interest rate forward linked to government debt (treasury forward)	Interest rates
Currency forward	Currency rates
Commodity forward	Commodity prices
Equity forward	Equity prices (equity instrument of another entity)

The above list provides examples of contracts that normally qualify as derivatives under PBE IPSAS 41. The list is not exhaustive. Any contract that has an underlying may be a derivative. Moreover, even if an instrument meets the definition of a derivative contract, special provisions may apply, for example, if it is a weather derivative (see paragraph AG1 of PBE IPSAS 41), a contract to buy or sell a non-financial item such as commodity (see paragraphs 6–8 and AG8 of PBE IPSAS 41) or a contract settled in an entity's own shares (see paragraphs 25–29 of PBE IPSAS 28 *Financial Instruments: Presentation*). Therefore, an entity must evaluate the contract to determine whether the other characteristics of a derivative are present and whether special provisions apply.

B.3 Definition of a Derivative: Settlement at a Future Date, Interest Rate Swap with Net or Gross Settlement

For the purpose of determining whether an interest rate swap is a derivative financial instrument under PBE IPSAS 41, does it make a difference whether the parties pay the interest payments to each other (gross settlement) or settle on a net basis?

No. The definition of a derivative does not depend on gross or net settlement.

To illustrate: Entity ABC enters into an interest rate swap with a counterparty (XYZ) that requires ABC to pay a fixed rate of 8 per cent and receive a variable amount based on three-month LIBOR, reset on a quarterly basis.

The fixed and variable amounts are determined based on a CU100 million notional amount. ABC and XYZ do not exchange the notional amount. ABC pays or receives a net cash amount each quarter based on the difference between 8 per cent and three-month LIBOR. Alternatively, settlement may be on a gross basis.

The contract meets the definition of a derivative regardless of whether there is net or gross settlement because its value changes in response to changes in an underlying variable (LIBOR), there is no initial net investment, and settlements occur at future dates.

B.4 Definition of a Derivative: Prepaid Interest Rate Swap (Fixed Rate Payment Obligation Prepaid at Inception or Subsequently)

If a party prepays its obligation under a pay-fixed, receive-variable interest rate swap at inception, is the swap a derivative financial instrument?

Yes. To illustrate: Entity S enters into a CU100 million notional amount five-year pay-fixed, receive-variable interest rate swap with Counterparty C. The interest rate of the variable part of the swap is reset on a quarterly basis to three-month LIBOR. The interest rate of the fixed part of the swap is 10 per cent per year. Entity S prepays its fixed obligation under the swap of CU50 million (CU100 million × 10% × 5 years) at inception, discounted using market interest rates, while retaining the right to receive interest payments on the CU100 million reset quarterly based on three-month LIBOR over the life of the swap.

The initial net investment in the interest rate swap is significantly less than the notional amount on which the variable payments under the variable leg will be calculated. The contract requires an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, such as a variable rate bond. Therefore, the contract fulfils the ‘no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors’ provision of PBE IPSAS 41. Even though Entity S has no future performance obligation, the ultimate settlement of the contract is at a future date and the value of the contract changes in response to changes in the LIBOR index. Accordingly, the contract is regarded as a derivative contract.

Would the answer change if the fixed rate payment obligation is prepaid subsequent to initial recognition?

If the fixed leg is prepaid during the term, that would be regarded as a termination of the old swap and an origination of a new instrument that is evaluated under PBE IPSAS 41.

B.5 Definition of a Derivative: Prepaid Pay-Variable, Receive-Fixed Interest Rate Swap

If a party prepays its obligation under a pay-variable, receive-fixed interest rate swap at inception of the contract or subsequently, is the swap a derivative financial instrument?

No. A prepaid pay-variable, receive-fixed interest rate swap is not a derivative if it is prepaid at inception and it is no longer a derivative if it is prepaid after inception because it provides a return on the prepaid (invested) amount comparable to the return on a debt instrument with fixed cash flows. The prepaid amount fails the ‘no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors’ criterion of a derivative.

To illustrate: Entity S enters into a CU100 million notional amount five-year pay-variable, receive-fixed interest rate swap with Counterparty C. The variable leg of the swap is reset on a quarterly basis to three-month LIBOR. The fixed interest payments under the swap are calculated as 10 per cent times the swap’s notional amount, i.e., CU10 million per year. Entity S prepays its obligation under the variable leg of the swap at inception at current market rates, while retaining the right to receive fixed interest payments of 10 per cent on CU100 million per year.

The cash inflows under the contract are equivalent to those of a financial instrument with a fixed annuity stream since Entity S knows it will receive CU10 million per year over the life of the swap. Therefore, all else being equal, the initial investment in the contract should equal that of other financial instruments that consist of fixed annuities. Thus, the initial net investment in the pay-variable, receive-fixed interest rate swap is equal to the investment required in a non-derivative contract that has a similar response to changes in market conditions. For this reason, the instrument fails the ‘no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors’ criterion of PBE IPSAS 41. Therefore, the contract is not accounted for as a derivative under PBE IPSAS 41. By discharging the obligation to pay variable interest rate payments, Entity S in effect provides a loan to Counterparty C.

B.6 Definition of a Derivative: Offsetting Loans

Entity A makes a five-year fixed rate loan to Entity B, while B at the same time makes a five-year variable rate loan for the same amount to A. There are no transfers of contractual par amount at inception of the two loans, since A and B have a netting agreement. Is this a derivative under PBE IPSAS 41?

Yes. This meets the definition of a derivative (that is to say, there is an underlying variable, no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, and future settlement). The contractual effect of the loans is the equivalent of an interest rate swap arrangement with no initial net investment. Non-derivative transactions are aggregated and treated as a derivative when the transactions result, in substance, in a derivative. Indicators of this would include:

- They are entered into at the same time and in contemplation of one another;
- They have the same counterparty;
- They relate to the same risk; and
- There is no apparent economic need or substantive business purpose for structuring the transactions separately that could not also have been accomplished in a single transaction.

The same answer would apply if Entity A and Entity B did not have a netting agreement, because the definition of a derivative instrument in PBE IPSAS 41 does not require net settlement.

B.7 Definition of a Derivative: Option Not Expected to be Exercised

The definition of a derivative in PBE IPSAS 41 requires that the instrument 'is settled at a future date'. Is this criterion met even if an option is expected not to be exercised, for example, because it is out of the money?

Yes. An option is settled upon exercise or at its maturity. Expiry at maturity is a form of settlement even though there is no additional exchange of consideration.

B.8 Definition of a Derivative: Foreign Currency Contract Based on Sales Volume

A South African entity, Entity XYZ, whose functional currency is the South African rand, sells electricity to Mozambique denominated in US dollars. XYZ enters into a contract with an investment bank to convert US dollars to rand at a fixed exchange rate. The contract requires XYZ to remit US dollars based on its sales volume in Mozambique in exchange for rand at a fixed exchange rate of 6.00. Is that contract a derivative?

Yes. The contract has two underlying variables (the foreign exchange rate and the volume of sales), no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, and a payment provision. PBE IPSAS 41 does not exclude from its scope derivatives that are based on sales volume.

B.9 Definition of a Derivative: Prepaid Forward

An entity enters into a forward contract to purchase shares of stock in one year at the forward price. It prepays at inception based on the current price of the shares. Is the forward contract a derivative?

No. The forward contract fails the 'no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors' test for a derivative.

To illustrate: Entity XYZ enters into a forward contract to purchase 1 million T ordinary shares in one year. The current market price of T is CU50 per share; the one-year forward price of T is CU55 per share. XYZ is required to prepay the forward contract at inception with a CU50 million payment. The initial investment in the forward contract of CU50 million is less than the notional amount applied to the underlying, 1 million shares at the forward price of CU55 per share, i.e., CU55 million. However, the initial net investment approximates the investment that would be required for other types of contracts that would be expected to have a similar response to changes in market factors because T's shares could be purchased at inception for the same price of CU50. Accordingly, the prepaid forward contract does not meet the initial net investment criterion of a derivative instrument.

While this instrument does not meet the definition of a derivative in its entirety, it meets the classification criteria of a financial asset to be measured at fair value through surplus or deficit. As the contractual terms of the forward contract do not include a requirement for Entity XYZ to receive cash flows that are solely payments of principal and interest, the instrument fails the conditions to be measured at amortised cost.

B.10 Definition of a Derivative: Initial Net Investment

Many derivative instruments, such as futures contracts and exchange traded written options, require margin accounts. Is the margin account part of the initial net investment?

No. The margin account is not part of the initial net investment in a derivative instrument. Margin accounts are a form of collateral for the counterparty or clearing house and may take the form of cash, securities or other specified assets, typically liquid assets. Margin accounts are separate assets that are accounted for separately.

B.11 Definition of Held for Trading: Portfolio with a Recent Actual Pattern of Short-Term Profit-Taking

The definition of a financial asset or financial liability held for trading states that 'a financial asset or financial liability is classified as held for trading if it is … part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking'. What is a 'portfolio' for the purposes of applying this definition?

Although the term 'portfolio' is not explicitly defined in PBE IPSAS 41, the context in which it is used suggests that a portfolio is a group of financial assets or financial liabilities that are managed as part of that group (paragraph 9 of PBE IPSAS 41). If there is evidence of a recent actual pattern of short-term profit-taking on financial instruments included in such a portfolio, those financial instruments qualify as held for trading even though an individual financial instrument may in fact be held for a longer period of time.

B.12 Definition of Gross Carrying Amount: Perpetual Debt Instruments with Fixed or Market-Based Variable Rate

Sometimes entities purchase or issue debt instruments that are required to be measured at amortised cost and in respect of which the issuer has no obligation to repay the gross carrying amount. The interest rate may be fixed or variable. Would the difference between the initial amount paid or received and zero ('the maturity amount') be amortised immediately on initial recognition for the purpose of determining amortised cost if the rate of interest is fixed or specified as a market-based variable rate?

No. Since there are no repayment of the gross carrying amount, there is no amortisation of the difference between the initial amount and the maturity amount if the rate of interest is fixed or specified as a market-based variable rate. Because interest payments are fixed or market-based and will be paid in perpetuity, the amortised cost (the present value of the stream of future cash payments discounted at the effective interest rate) equals the gross carrying amount in each period.

B.13 Definition of Gross Carrying Amount: Perpetual Debt Instruments with Decreasing Interest Rate

If the stated rate of interest on a perpetual debt instrument decreases over time, would the gross carrying amount equal the contractual par amount in each period?

No. From an economic perspective, some or all of the contractual interest payments are repayments of the gross carrying amount. For example, the interest rate may be stated as 16 per cent for the first 10 years and as zero per cent in subsequent periods. In that case, the initial amount is amortised to zero over the first 10 years using the effective interest method, since a portion of the contractual interest payments represents repayments of the gross carrying amount. The gross carrying amount is zero after Year 10 because the present value of the stream of future cash payments in subsequent periods is zero (there are no further contractual cash payments in subsequent periods).

B.14 Example of Calculating the Gross Carrying Amount: Financial Asset

How is the gross carrying amount calculated for financial assets measured at amortised cost in accordance with PBE IPSAS 41?

The gross carrying amount is calculated using the effective interest method. The effective interest rate inherent in a financial instrument is the rate that exactly discounts the estimated cash flows associated with the financial instrument through the expected life of the instrument or, where appropriate, a shorter period to the gross carrying amount at initial recognition. The computation includes all fees and points paid or received that are an integral part of the effective interest rate, directly attributable transaction costs and all other premiums or discounts.

The following example illustrates how the gross carrying amount is calculated using the effective interest method. Entity A purchases a debt instrument with five years remaining to maturity for its fair value of CU1,000 (including transaction costs). The instrument has a contractual par amount of CU1,250 and carries fixed interest of 4.7 per cent that is paid annually (CU1,250 × 4.7% = CU59 per year). The contract also specifies that the borrower has an option to prepay the instrument at par and that no penalty will be charged for prepayment. At inception, the entity expects the borrower not to prepay (and, therefore, the entity determines that the fair value of the prepayment feature is insignificant when the financial asset is initially recognised).

It can be shown that in order to allocate interest receipts and the initial discount over the term of the debt instrument at a constant rate on the carrying amount, they must be accrued at the rate of 10 per cent annually. The table below provides information about the gross carrying amount, interest revenue and cash flows of the debt instrument in each reporting period.

Year	(a) Gross carrying amount at the beginning of the year	(b = a × 10%) Interest revenue	(c) Cash flows	(d = a + b – c) Gross carrying amount at the end of the year
20X0	1,000	100	59	1,041
20X1	1,041	104	59	1,086
20X2	1,086	109	59	1,136
20X3	1,136	113	59	1,190
20X4	1,190	119	1,250 + 59	–

On the first day of 20X2 the entity revises its estimate of cash flows. It now expects that 50 per cent of the contractual par amount will be prepaid at the end of 20X2 and the remaining 50 per cent at the end of 20X4. In accordance with paragraph AG161 of PBE IPSAS 41, the gross carrying amount of the debt instrument in 20X2 is adjusted. The gross carrying amount is recalculated by discounting the amount the entity expects to receive in 20X2 and subsequent years using the original effective interest rate (10 per cent). This results in the new gross carrying amount in 20X2 of CU1,138. The adjustment of CU52 (CU1,138 – CU1,086) is recorded in surplus or deficit in 20X2. The table below provides information about the gross carrying amount, interest revenue and cash flows as they would be adjusted taking into account the change in estimate.

Year	(a) Gross carrying amount at the beginning of the year	(b = a × 10%) Interest revenue	(c) Cash flows	(d = a + b – c) Gross carrying amount at the end of the year
20X0	1,000	100	59	1,041
20X1	1,041	104	59	1,086
20X2	1,086 + 52	114	625 + 59	568
20X3	568	57	30	595
20X4	595	60	625 + 30	–

B.15 Example of Calculating the Gross Carrying Amount: Debt Instruments with Stepped Interest Payments

Sometimes entities purchase or issue debt instruments with a predetermined rate of interest that increases or decreases progressively (‘stepped interest’) over the term of the debt instrument. If a debt instrument with stepped interest is issued at CU1,250 and has a maturity amount of CU1,250, would the gross carrying amount equal CU1,250 in each reporting period over the term of the debt instrument?

No. Although there is no difference between the initial amount and maturity amount, an entity uses the effective interest method to allocate interest payments over the term of the debt instrument to achieve a constant rate on the carrying amount.

The following example illustrates how the gross carrying amount is calculated using the effective interest method for an instrument with a predetermined rate of interest that increases or decreases over the term of the debt instrument (‘stepped interest’).

On January 1, 20X0, Entity A issues a debt instrument for a price of CU1,250. The contractual par amount is CU1,250 and the debt instrument is repayable on December 31, 20X4. The rate of interest is specified in the debt agreement as a percentage of the contractual par amount as follows: 6.0 per cent in 20X0 (CU75), 8.0 per cent in 20X1 (CU100), 10.0 per cent in 20X2 (CU125), 12.0 per cent in 20X3 (CU150), and 16.4 per cent in 20X4 (CU205). In this case, the interest rate that exactly discounts the stream of future cash payments through maturity is 10 per cent. Therefore, cash interest payments are reallocated over the term of the debt instrument for the purposes of determining the gross carrying amount in each period. In each period, the gross carrying amount at the beginning of the period is multiplied by the effective interest rate of 10 per cent and added to the gross carrying amount. Any cash payments in the period are deducted from the resulting number. Accordingly, the gross carrying amount in each period is as follows:

Year	**(a) Gross carrying amount at the beginning of the year**	**(b = a × 10%) Interest revenue**	**(c) Cash flows**	**(d = a + b – c) Gross carrying amount at the end of the year**
20X0	1,250	125	75	1,300
20X1	1,300	130	100	1,330
20X2	1,330	133	125	1,338
20X3	1,338	134	150	1,322
20X4	1,322	133	1,250 + 205	–

B.16 Regular Way Contracts: No Established Market

Can a contract to purchase a financial asset be a regular way contract if there is no established market for trading such a contract?

Yes. PBE IPSAS 41 refers to terms that require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned. Marketplace is not limited to a formal stock exchange or organised over-the-counter market. Instead, it means the environment in which the financial asset is customarily exchanged. An acceptable time frame would be the period reasonably and customarily required for the parties to complete the transaction and prepare and execute closing documents.

For example, a market for private issue financial instruments can be a marketplace.

B.17 Regular Way Contracts: Forward Contract

Entity ABC enters into a forward contract to purchase 1 million of M's ordinary shares in two months for CU10 per share. The contract is not an exchange-traded contract. The contract requires ABC to take physical delivery of the shares and pay the counterparty CU10 million in cash. M's shares trade in an active public market at an average of 100,000 shares a day. Regular way delivery is three days. Is the forward contract regarded as a regular way contract?

No. The contract must be accounted for as a derivative because it is not settled in the way established by regulation or convention in the marketplace concerned.

B.18 Regular Way Contracts: Which Customary Settlement Provisions Apply?

If an entity's financial instruments trade in more than one active market, and the settlement provisions differ in the various active markets, which provisions apply in assessing whether a contract to purchase those financial instruments is a regular way contract?

The provisions that apply are those in the market in which the purchase actually takes place.

To illustrate: Entity XYZ purchases 1 million shares of Entity ABC on a US stock exchange, for example, through a broker. The settlement date of the contract is six business days later. Trades for equity shares on US exchanges customarily settle in three business days. Because the trade settles in six business days, it does not meet the exemption as a regular way trade.

However, if XYZ did the same transaction on a foreign exchange that has a customary settlement period of six business days, the contract would meet the exemption for a regular way trade.

B.19 Regular Way Contracts: Share Purchase by Call Option

Entity A purchases a call option in a public market permitting it to purchase 100 shares of Entity XYZ at any time over the next three months at a price of CU100 per share. If Entity A exercises its option, it has 14 days to settle the transaction according to regulation or convention in the options market. XYZ shares are traded in an active public market that requires three-day settlement. Is the purchase of shares by exercising the option a regular way purchase of shares?

Yes. The settlement of an option is governed by regulation or convention in the marketplace for options and, therefore, upon exercise of the option it is no longer accounted for as a derivative because settlement by delivery of the shares within 14 days is a regular way transaction.

B.20 Recognition and Derecognition of Financial Liabilities Using Trade Date or Settlement Date Accounting

PBE IPSAS 41 has special rules about recognition and derecognition of financial assets using trade date or settlement date accounting. Do these rules apply to transactions in financial instruments that are classified as financial liabilities, such as transactions in deposit liabilities and trading liabilities?

No. PBE IPSAS 41 does not contain any specific requirements about trade date accounting and settlement date accounting in the case of transactions in financial instruments that are classified as financial liabilities. Therefore, the general recognition and derecognition requirements in paragraphs 10 and 35 of PBE IPSAS 41 apply. Paragraph 10 of PBE IPSAS 41 states that financial liabilities are recognised on the date the entity 'becomes a party to the contractual provisions of the instrument'. Such contracts generally are not recognised unless one of the parties has performed or the contract is a derivative contract not exempted from the scope of PBE IPSAS 41. Paragraph 35 of PBE IPSAS 41 specifies that financial liabilities are derecognised only when they are extinguished, i.e., when the obligation specified in the contract is discharged or cancelled or expires.

Section C Embedded Derivatives

C.1 Embedded Derivatives: Separation of Host Debt Instrument

If an embedded non-option derivative is required to be separated from a host debt instrument, how are the terms of the host debt instrument and the embedded derivative identified? For example, would the host debt instrument be a fixed rate instrument, a variable rate instrument or a zero coupon instrument?

The terms of the host debt instrument reflect the stated or implied substantive terms of the hybrid contract. In the absence of implied or stated terms, the entity makes its own judgement of the terms. However, an entity may not identify a component that is not specified or may not establish terms of the host debt instrument in a manner that would result in the separation of an embedded derivative that is not already clearly present in the hybrid contract, that is to say, it cannot create a cash flow that does not exist. For example, if a five-year debt instrument has fixed interest payments of CU40,000 annually and a contractual payment at maturity of CU1,000,000 multiplied by the change in an equity price index, it would be inappropriate to identify a floating rate host contract and an embedded equity swap that has an offsetting floating rate leg in lieu of identifying a fixed rate host. In that example, the host contract is a fixed rate debt instrument that pays CU40,000 annually because there are no floating interest rate cash flows in the hybrid contract.

In addition, the terms of an embedded non-option derivative, such as a forward or swap, must be determined so as to result in the embedded derivative having a fair value of zero at the inception of the hybrid contract. If it were permitted to separate embedded non-option derivatives on other terms, a single hybrid contract could be decomposed into an infinite variety of combinations of host debt instruments and embedded derivatives, for example, by separating embedded derivatives with terms that create leverage, asymmetry or some other risk exposure not already present in the hybrid contract. Therefore, it is inappropriate to separate an embedded non-option derivative on terms that result in a fair value other than zero at the inception of the hybrid contract. The determination of the terms of the embedded derivative is based on the conditions existing when the financial instrument was issued.

C.2 Embedded Derivatives: Separation of Embedded Option

The response to Question C.1 states that the terms of an embedded non-option derivative should be determined so as to result in the embedded derivative having a fair value of zero at the initial recognition

of the hybrid contract. When an embedded option-based derivative is separated, must the terms of the embedded option be determined so as to result in the embedded derivative having either a fair value of zero or an intrinsic value of zero (that is to say, be at the money) at the inception of the hybrid contract?

No. The economic behaviour of a hybrid contract with an option-based embedded derivative depends critically on the strike price (or strike rate) specified for the option feature in the hybrid contract, as discussed below. Therefore, the separation of an option-based embedded derivative (including any embedded put, call, cap, floor, caption, floortion or swaption feature in a hybrid contract) should be based on the stated terms of the option feature documented in the hybrid contract. As a result, the embedded derivative would not necessarily have a fair value or intrinsic value equal to zero at the initial recognition of the hybrid contract.

If an entity were required to identify the terms of an embedded option-based derivative so as to achieve a fair value of the embedded derivative of zero, the strike price (or strike rate) generally would have to be determined so as to result in the option being infinitely out of the money. This would imply a zero probability of the option feature being exercised. However, since the probability of the option feature in a hybrid contract being exercised generally is not zero, it would be inconsistent with the likely economic behaviour of the hybrid contract to assume an initial fair value of zero. Similarly, if an entity were required to identify the terms of an embedded option-based derivative so as to achieve an intrinsic value of zero for the embedded derivative, the strike price (or strike rate) would have to be assumed to equal the price (or rate) of the underlying variable at the initial recognition of the hybrid contract. In this case, the fair value of the option would consist only of time value. However, such an assumption would not be consistent with the likely economic behaviour of the hybrid contract, including the probability of the option feature being exercised, unless the agreed strike price was indeed equal to the price (or rate) of the underlying variable at the initial recognition of the hybrid contract.

The economic nature of an option-based embedded derivative is fundamentally different from a forward-based embedded derivative (including forwards and swaps), because the terms of a forward are such that a payment based on the difference between the price of the underlying and the forward price will occur at a specified date, while the terms of an option are such that a payment based on the difference between the price of the underlying and the strike price of the option may or may not occur depending on the relationship between the agreed strike price and the price of the underlying at a specified date or dates in the future. Adjusting the strike price of an option-based embedded derivative, therefore, alters the nature of the hybrid contract. On the other hand, if the terms of a non-option embedded derivative in a host debt instrument were determined so as to result in a fair value of any amount other than zero at the inception of the hybrid contract, that amount would essentially represent a borrowing or lending. Accordingly, as discussed in the answer to Question C.1, it is not appropriate to separate a non-option embedded derivative in a host debt instrument on terms that result in a fair value other than zero at the initial recognition of the hybrid contract.

C.3 Embedded Derivatives: Equity Kicker

In some instances, investment entities providing subordinated loans agree that if and when the borrower lists its shares on a stock exchange, the venture capital entity is entitled to receive shares of the borrowing entity free of charge or at a very low price (an 'equity kicker') in addition to the contractual payments. As a result of the equity kicker feature, the interest on the subordinated loan is lower than it would otherwise be. Assuming that the subordinated loan is not measured at fair value with changes in fair value recognised in surplus or deficit (paragraph 49(c) of PBE IPSAS 41), does the equity kicker feature meet the definition of an embedded derivative even though it is contingent upon the future listing of the borrower?

Yes. The economic characteristics and risks of an equity return are not closely related to the economic characteristics and risks of a host debt instrument (paragraph 49(a) of PBE IPSAS 41). The equity kicker meets the definition of a derivative because it has a value that changes in response to the change in the price of the shares of the borrower, it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, and it is settled at a future date (paragraph 49(b) and paragraph 9 of PBE IPSAS 41). The equity kicker feature meets the definition of a derivative even though the right to receive shares is contingent upon the future listing of the borrower. Paragraph AG7 of PBE IPSAS 41 states that a derivative could require a payment as a result of some future event that is unrelated to a notional amount. An equity kicker feature is similar to such a derivative except that it does not give a right to a fixed payment, but an option right, if the future event occurs.

C.4 Embedded Derivatives: Synthetic Instruments

Entity A issues a five-year floating rate debt instrument. At the same time, it enters into a five-year pay-fixed, receive-variable interest rate swap with Entity B. Entity A regards the combination of the debt instrument and swap as a synthetic fixed rate instrument. Entity A contends that separate accounting for the swap is inappropriate since paragraph AG106(a) of PBE IPSAS 41 requires an embedded derivative to be classified together with its host instrument if the derivative is linked to an interest rate that can change the amount of contractual interest that would otherwise be paid or received on the host debt contract. Is the entity's analysis correct?

No. Embedded derivative instruments are terms and conditions that are included in non-derivative host contracts. It is generally inappropriate to treat two or more separate financial instruments as a single combined instrument ('synthetic instrument' accounting) for the purpose of applying PBE IPSAS 41. Each of the financial instruments has its own terms and conditions and each may be transferred or settled separately. Therefore, the debt instrument and the swap are classified separately. The transactions described here differ from the transactions discussed in Question B.6, which had no substance apart from the resulting interest rate swap.

C.5 Embedded Derivatives: Purchases and Sales Contracts in Foreign Currency Instruments

A supply contract provides for payment in a currency other than (a) the functional currency of either party to the contract, (b) the currency in which the product is routinely denominated in commercial transactions around the world and (c) the currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place. Is there an embedded derivative that should be separated under PBE IPSAS 41?

Yes. To illustrate: a Norwegian entity agrees to sell oil to an entity in France. The oil contract is denominated in Swiss francs, although oil contracts are routinely denominated in US dollars in commercial transactions around the world, and Norwegian krone are commonly used in contracts to purchase or sell non-financial items in Norway. Neither entity carries out any significant activities in Swiss francs. In this case, the Norwegian entity regards the supply contract as a host contract with an embedded foreign currency forward to purchase Swiss francs. The French entity regards the supply contact as a host contract with an embedded foreign currency forward to sell Swiss francs. Each entity includes fair value changes on the currency forward in surplus or deficit unless the reporting entity designates it as a cash flow hedging instrument, if appropriate.

C.6 Embedded Foreign Currency Derivatives: Unrelated Foreign Currency Provision

Entity A, which measures items in its financial statements on the basis of the euro (its functional currency), enters into a contract with Entity B, which has the Norwegian krone as its functional currency, to purchase oil in six months for 1,000 US dollars. The host oil contract is not within the scope of PBE IPSAS 41 because it was entered into and continues to be for the purpose of delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements (paragraphs 5 and AG8 of PBE IPSAS 41) and the entity has not irrevocably designated it as measured at fair value through surplus or deficit in accordance with paragraph 6 of PBE IPSAS 41. The oil contract includes a leveraged foreign exchange provision that states that the parties, in addition to the provision of, and payment for, oil will exchange an amount equal to the fluctuation in the exchange rate of the US dollar and Norwegian krone applied to a notional amount of 100,000 US dollars. Under paragraph 49 of PBE IPSAS 41, is that embedded derivative (the leveraged foreign exchange provision) regarded as closely related to the host oil contract?

No, that leveraged foreign exchange provision is separated from the host oil contract because it is not closely related to the host oil contract (paragraph AG106(d) of PBE IPSAS 41).

The payment provision under the host oil contract of 1,000 US dollars can be viewed as a foreign currency derivative because the US dollar is neither Entity A's nor Entity B's functional currency. This foreign currency derivative would not be separated because it follows from paragraph AG106(d) of PBE IPSAS 41 that a crude oil contract that requires payment in US dollars is not regarded as a host contract with a foreign currency derivative.

The leveraged foreign exchange provision that states that the parties will exchange an amount equal to the fluctuation in the exchange rate of the US dollar and Norwegian krone applied to a notional amount of 100,000 US dollars is in addition to the required payment for the oil transaction. It is unrelated to the host oil contract and therefore separated from the host oil contract and accounted for as an embedded derivative under paragraph 49 of PBE IPSAS 41.

C.7 Embedded Foreign Currency Derivatives: Currency of International Commerce

Paragraph AG106(d) of PBE IPSAS 41 refers to the currency in which the price of the related goods or services is routinely denominated in commercial transactions around the world. Could it be a currency that is used for a certain product or service in commercial transactions within the local area of one of the substantial parties to the contract?

No. The currency in which the price of the related goods or services is routinely denominated in commercial transactions around the world is only a currency that is used for similar transactions all around the world, not just in one local area. For example, if cross-border transactions in natural gas in North America are routinely denominated in US dollars and such transactions are routinely denominated in euro in Europe, neither the US dollar nor the euro is a currency in which the goods or services are routinely denominated in commercial transactions around the world.

C.8 Embedded Derivatives: Holder Permitted, but not Required, to Settle Without Recovering Substantially all of its Recognised Investment

If the terms of a combined contract permit, but do not require, the holder to settle the combined contract in a manner that causes it not to recover substantially all of its recognised investment and the issuer does not have such a right (for example, a puttable debt instrument), does the contract satisfy the condition in paragraph AG106(a) of PBE IPSAS 41 that the holder would not recover substantially all of its recognised investment?

No. The condition that 'the holder would not recover substantially all of its recognised investment' is not satisfied if the terms of the combined contract permit, but do not require, the investor to settle the combined contract in a manner that causes it not to recover substantially all of its recognised investment and the issuer has no such right. Accordingly, an interest-bearing host contract with an embedded interest rate derivative with such terms is regarded as closely related to the host contract. The condition that 'the holder would not recover substantially all of its recognised investment' applies to situations in which the holder can be forced to accept settlement at an amount that causes the holder not to recover substantially all of its recognised investment.

Section D Recognition and Derecognition

D.1 Initial Recognition

D.1.1 Recognition: Cash Collateral

Entity B transfers cash to Entity A as collateral for another transaction with Entity A (for example, a securities borrowing transaction). The cash is not legally segregated from Entity A's assets. Should Entity A recognise the cash collateral it has received as an asset?

Yes. The ultimate realisation of a financial asset is its conversion into cash and, therefore, no further transformation is required before the economic benefits of the cash transferred by Entity B can be realised by Entity A. Therefore, Entity A recognises the cash as an asset and a payable to Entity B while Entity B derecognises the cash and recognises a receivable from Entity A.

D.2 Regular Way Purchase or Sale of a Financial Asset

D.2.1 Trade Date vs Settlement Date: Amounts to be Recorded for a Purchase

How are the trade date and settlement date accounting principles in PBE IPSAS 41 applied to a purchase of a financial asset?

The following example illustrates the application of the trade date and settlement date accounting principles in PBE IPSAS 41 for a purchase of a financial asset. On December 29, 20X1, an entity commits itself to purchase a financial asset for CU1,000, which is its fair value on commitment (trade) date. Transaction costs are immaterial. On December 31, 20X1 (financial year-end) and on January 4, 20X2 (settlement date) the fair value of the asset is CU1,002 and CU1,003, respectively. The amounts to be recorded for the asset will depend on how it is classified and whether trade date or settlement date accounting is used, as shown in the two tables below.

Settlement date accounting			
Balances	**Financial assets measured at amortised cost**	**Financial assets measured at fair value through other comprehensive revenue and expense**	**Financial assets measured at fair value through surplus or deficit**
December 29, 20X1			
Financial asset	–	–	–
Financial liability	–	–	–
December 31, 20X1			
Receivable	–	2	2
Financial asset	–	–	–
Financial liability	–	–	–
Other comprehensive revenue and expense (fair value adjustment)	–	(2)	–
Accumulated surplus or deficit (through surplus or deficit)	–	–	(2)
January 4, 20X2			
Receivable	–	–	–
Financial asset	1,000	1,003	1,003
Financial liability	–	–	–
Other comprehensive revenue and expense (fair value adjustment)	–	(3)	–
Accumulated surplus or deficit (through surplus or deficit)	–	–	(3)

Trade date accounting			
Balances	**Financial assets measured at amortised cost**	**Financial assets measured at fair value through other comprehensive revenue and expense**	**Financial assets measured at fair value through surplus or deficit**
December 29, 20X1			
Financial asset	1,000	1,000	1,000
Financial liability	(1,000)	(1,000)	(1,000)
December 31, 20X1			
Receivable	–	–	–
Financial asset	1,000	1,002	1,002
Financial liability	(1,000)	(1,000)	(1,000)
Other comprehensive revenue and expense (fair value adjustment)	–	(2)	–
Accumulated surplus or deficit (through surplus or deficit)	–	–	(2)
January 4, 20X2			
Receivable	–	–	–
Financial asset	1,000	1,003	1,003
Financial liability	–	–	–
Other comprehensive revenue and expense (fair value adjustment)	–	(3)	–
Accumulated surplus or deficit (through surplus or deficit)	–	–	(3)

D.2.2 Trade Date vs Settlement Date: Amounts to be Recorded for a Sale

How are the trade date and settlement date accounting principles in PBE IPSAS 41 applied to a sale of a financial asset?

The following example illustrates the application of the trade date and settlement date accounting principles in PBE IPSAS 41 for a sale of a financial asset. On December 29, 20X2 (trade date) an entity enters into a contract to sell a financial asset for its current fair value of CU1,010. The asset was acquired one year earlier for CU1,000 and its gross carrying amount is CU1,000. On December 31, 20X2 (financial year-end), the fair value of the asset is CU1,012. On January 4, 20X3 (settlement date), the fair value is CU1,013. The amounts to be recorded will depend on how the asset is classified and whether trade date or settlement date accounting is used as shown in the two tables below (any loss allowance or interest revenue on the financial asset is disregarded for the purpose of this example).

A change in the fair value of a financial asset that is sold on a regular way basis is not recorded in the financial statements between trade date and settlement date even if the entity applies settlement date accounting because the seller's right to changes in the fair value ceases on the trade date.

Settlement date accounting			
Balances	**Financial assets measured at amortised cost**	**Financial assets measured at fair value through other comprehensive revenue and expense**	**Financial assets measured at fair value through surplus or deficit**
December 29, 20X2			
Receivable	–	–	–
Financial asset	1,000	1,010	1,010
Other comprehensive revenue and expense (fair value adjustment)	–	10	–
Accumulated surplus or deficit (through surplus or deficit)	–	–	10
December 31, 20X2			
Receivable	–	–	–
Financial asset	1,000	1,010	1,010
Other comprehensive revenue and expense (fair value adjustment)	–	10	–
Accumulated surplus or deficit (through surplus or deficit)	–	–	10
January 4, 20X3			
Other comprehensive revenue and expense (fair value adjustment)	–	–	–
Accumulated surplus or deficit (through surplus or deficit)	10	10	10

Trade date accounting			
Balances	**Financial assets measured at amortised cost**	**Financial assets measured at fair value through other comprehensive revenue and expense**	**Financial assets measured at fair value through surplus or deficit**
December 29, 20X2			
Receivable	1,010	1,010	1,010
Financial asset	–	–	–
Other comprehensive revenue and expense (fair value adjustment)	–	–	–
Accumulated surplus or deficit (through surplus or deficit)	10	10	10

Trade date accounting			
Balances	**Financial assets measured at amortised cost**	**Financial assets measured at fair value through other comprehensive revenue and expense**	**Financial assets measured at fair value through surplus or deficit**
December 31, 20X2			
Receivable	1,010	1,010	1,010
Financial asset	–	–	–
Other comprehensive revenue and expense (fair value adjustment)	–	–	–
Accumulated surplus or deficit (through surplus or deficit)	10	10	10
January 4, 20X3			
Other comprehensive revenue and expense (fair value adjustment)	–	–	–
Accumulated surplus or deficit (through surplus or deficit)	10	10	10

D.2.3 Settlement Date Accounting: Exchange of Non-cash Financial Assets

If an entity recognises sales of financial assets using settlement date accounting, would a change in the fair value of a financial asset to be received in exchange for the non-cash financial asset that is sold be recognised in accordance with paragraph 105 of PBE IPSAS 41?

It depends. Any change in the fair value of the financial asset to be received would be accounted for under paragraph 105 of PBE IPSAS 41 if the entity applies settlement date accounting for that category of financial assets. However, if the entity classifies the financial asset to be received in a category for which it applies trade date accounting, the asset to be received is recognised on the trade date as described in paragraph AG19 of PBE IPSAS 41. In that case, the entity recognises a liability of an amount equal to the carrying amount of the financial asset to be delivered on settlement date.

To illustrate: on December 29, 20X2 (trade date) Entity A enters into a contract to sell Note Receivable A, which is measured at amortised cost, in exchange for Bond B, which meets the definition of held for trading and is measured at fair value. Both assets have a fair value of CU1,010 on December 29, while the amortised cost of Note Receivable A is CU1,000. Entity A uses settlement date accounting for financial assets measured at amortised cost and trade date accounting for assets that meet the definition of held for trading. On December 31, 20X2 (financial year-end), the fair value of Note Receivable A is CU1,012 and the fair value of Bond B is CU1,009. On January 4, 20X3, the fair value of Note Receivable A is CU1,013 and the fair value of Bond B is CU1,007. The following entries are made:

December 29, 20X2			
Dr	Bond B	CU1,010	
	Cr Payable		CU1,010
December 31, 20X2			
Dr	Trading loss	CU1	
	Cr Bond B		CU1
January 4, 20X3			
Dr	Payable	CU1,010	
Dr	Trading loss	CU2	
	Cr Note Receivable A		CU1,000
	Cr Bond B		CU2
	Cr Realisation gain		CU10

Section E Measurement

E.1 Initial Measurement of Financial Assets and Financial Liabilities

E.1.1 Initial Measurement: Transaction Costs

Transaction costs should be included in the initial measurement of financial assets and financial liabilities other than those at fair value through surplus or deficit. How should this requirement be applied in practice?

For financial assets not measured at fair value through surplus or deficit, transaction costs are added to the fair value at initial recognition. For financial liabilities, transaction costs are deducted from the fair value at initial recognition.

For financial instruments that are measured at amortised cost, transaction costs are subsequently included in the calculation of amortised cost using the effective interest method and, in effect, amortised through surplus or deficit over the life of the instrument.

For financial instruments that are measured at fair value through other comprehensive revenue and expense in accordance with either paragraphs 41 and 111 or paragraphs 43 and 106 of PBE IPSAS 41, transaction costs are recognised in other comprehensive revenue and expense as part of a change in fair value at the next remeasurement. If the financial asset is measured in accordance with paragraphs 441 and 111 of PBE IPSAS 41, those transaction costs are amortised to surplus or deficit using the effective interest method and, in effect, amortised through surplus or deficit over the life of the instrument.

Transaction costs expected to be incurred on transfer or disposal of a financial instrument are not included in the measurement of the financial instrument.

E.2 Gains and Losses

E.2.1 PBE IPSAS 41 and PBE IPSAS 4—Financial Assets Measured at Fair Value Through Other Comprehensive Revenue and Expense: Separation of Currency Component

A financial asset measured at fair value through other comprehensive revenue and expense in accordance with paragraph 41 of PBE IPSAS 41 is treated as a monetary item. Therefore, the entity recognises changes in the carrying amount relating to changes in foreign exchange rates in surplus or deficit in accordance with paragraphs 27(a) and 32 of PBE IPSAS 4 *The Effects of Changes in Foreign Exchange Rates* and other changes in the carrying amount in other comprehensive revenue and expense in accordance with PBE IPSAS 41. How is the cumulative gain or loss that is recognised in other comprehensive revenue and expense determined?

It is the difference between the amortised cost of the financial asset[58] and the fair value of the financial asset in the functional currency of the reporting entity. For the purpose of applying paragraph 32 of PBE IPSAS 4 the asset is treated as an asset measured at amortised cost in the foreign currency.

To illustrate: on December 31, 20X1 Entity A acquires a bond denominated in a foreign currency (FC) for its fair value of FC1,000. The bond has five years remaining to maturity and a contractual par amount of FC1,250, carries fixed interest of 4.7 per cent that is paid annually (FC1,250 × 4.7% = FC59 per year), and has an effective interest rate of 10 per cent. Entity A classifies the bond as subsequently measured at fair value through other comprehensive revenue and expense in accordance with paragraph 41 of PBE IPSAS 41, and thus recognises gains and losses in other comprehensive revenue and expense. The entity's functional currency is its local currency (LC). The exchange rate is FC1 to LC1.5 and the carrying amount of the bond is LC1,500 (= FC1,000 × 1.5).

Dr	Bond	LC1,500	
	Cr Cash		LC1,500

On December 31, 20X2, the foreign currency has appreciated and the exchange rate is FC1 to LC2. The fair value of the bond is FC1,060 and thus the carrying amount is LC2,120 (= FC1,060 × 2). The amortised cost is FC1,041 (= LC2,082). In this case, the cumulative gain or loss to be recognised in other comprehensive revenue and

58 The objective of this example is to illustrate the separation of the currency component for a financial asset that is measured at fair value through other comprehensive revenue and expense in accordance with paragraph 41 of PBE IPSAS 41. Consequently, for simplicity, this example does not reflect the effect of the impairment requirements in paragraphs 73–93 of PBE IPSAS 41.

expense and accumulated in net assets/equity is the difference between the fair value and the amortised cost on December 31, 20X2, i.e., LC38 (= LC2,120 – LC2,082).

Interest received on the bond on December 31, 20X2 is FC59 (= LC118). Interest revenue determined in accordance with the effective interest method is FC100 (= FC1,000 × 10 per cent). The average exchange rate during the year is FC1 to LC1.75. For the purpose of this question, it is assumed that the use of the average exchange rate provides a reliable approximation of the spot rates applicable to the accrual of interest revenue during the year (see paragraph 25 of PBE IPSAS 4). Thus, reported interest revenue is LC175 (= FC100 × 1.75) including accretion of the initial discount of LC72 (= [FC100 – FC59] × 1.75). Accordingly, the exchange difference on the bond that is recognised in surplus or deficit is LC510 (= LC2,082 – LC1,500 – LC72). Also, there is an exchange gain on the interest receivable for the year of LC15 (= FC59 × [2.00 – 1.75]).

Dr	Bond		LC620	
Dr	Cash		LC118	
	Cr	Interest revenue		LC175
	Cr	Exchange gain		LC525
	Cr	Fair value change in other comprehensive revenue and expense		LC38

On December 31, 20X3, the foreign currency has appreciated further and the exchange rate is FC1 to LC2.50. The fair value of the bond is FC1,070 and thus the carrying amount is LC2,675 (= FC1,070 × 2.50). The amortised cost is FC1,086 (= LC2,715). The cumulative gain or loss to be accumulated in other comprehensive revenue and expense is the difference between the fair value and the amortised cost on December 31, 20X3, i.e., negative LC40 (= LC2,675 – LC2,715). Thus, the amount recognised in other comprehensive revenue and expense equals the change in the difference during 20X3 of LC78 (= LC40 + LC38).

Interest received on the bond on December 31, 20X3 is FC59 (= LC148). Interest revenue determined in accordance with the effective interest method is FC104 (= FC1,041 × 10%). The average exchange rate during the year is FC1 to LC2.25. For the purpose of this question, it is assumed that the use of the average exchange rate provides a reliable approximation of the spot rates applicable to the accrual of interest revenue during the year (see paragraph 25 of PBE IPSAS 4). Thus, recognised interest revenue is LC234 (= FC104 × 2.25) including accretion of the initial discount of LC101 (= [FC104 – FC59] × 2.25). Accordingly, the exchange difference on the bond that is recognised in surplus or deficit is LC532 (= LC2,715 – LC2,082 – LC101). Also, there is an exchange gain on the interest receivable for the year of LC15 (= FC59 × [2.50 – 2.25]).

Dr	Bond		LC555	
Dr	Cash		LC148	
Dr	Fair value change in other comprehensive revenue and expense		LC78	
	Cr	Interest revenue		LC234
	Cr	Exchange gain		LC547

E.2.2 PBE IPSAS 41 and PBE IPSAS 4—Exchange Differences Arising on Translation of Foreign Entities: Other Comprehensive Revenue and Expense or Surplus or Deficit?

Paragraphs 37 and 57 of PBE IPSAS 4 state that all exchange differences resulting from translating the financial statements of a foreign operation should be recognised in other comprehensive revenue and expense until disposal of the net investment. This would include exchange differences arising from financial instruments carried at fair value, which would include both financial assets measured at fair value through surplus or deficit and financial assets that are measured at fair value through other comprehensive revenue and expense in accordance with PBE IPSAS 41.

PBE IPSAS 41 requires that changes in fair value of financial assets measured at fair value through surplus or deficit should be recognised in surplus or deficit and changes in fair value of financial assets measured at fair value through other comprehensive revenue and expense should be recognised in other comprehensive revenue and expense.

If the foreign operation is a controlled entity whose financial statements are consolidated with those of its controlling entity, in the consolidated financial statements how are PBE IPSAS 41 and paragraph 44 of PBE IPSAS 4 applied?

PBE IPSAS 41 applies in the accounting for financial instruments in the financial statements of a foreign operation and PBE IPSAS 4 applies in translating the financial statements of a foreign operation for incorporation in the financial statements of the reporting entity.

To illustrate: Entity A is domiciled in Country X and its functional currency and presentation currency are the local currency of Country X (LCX). Entity A has a foreign controlled entity (Entity B) in Country Y whose functional currency is the local currency of Country Y (LCY). Entity B is the owner of a debt instrument, which meets the definition of held for trading and is therefore measured at fair value through surplus or deficit in accordance with PBE IPSAS 41.

In Entity B's financial statements for year 20X0, the fair value and carrying amount of the debt instrument is LCY100 in the local currency of Country Y. In Entity A's consolidated financial statements, the asset is translated into the local currency of Country X at the spot exchange rate applicable at the end of the reporting period (2.00). Thus, the carrying amount is LCX200 (= LCY100 × 2.00) in the consolidated financial statements.

At the end of year 20X1, the fair value of the debt instrument has increased to LCY110 in the local currency of Country Y. Entity B recognises the trading asset at LCY110 in its statement of financial position and recognises a fair value gain of LCY10 in its surplus or deficit. During the year, the spot exchange rate has increased from 2.00 to 3.00 resulting in an increase in the fair value of the instrument from LCX200 to LCX330 (= LCY110 × 3.00) in the currency of Country X. Therefore, Entity A recognises the trading asset at LCX330 in its consolidated financial statements.

Entity A translates the statement of comprehensive revenue and expense of Entity B 'at the exchange rates at the dates of the transactions' (paragraph 44(b) of PBE IPSAS 4). Since the fair value gain has accrued through the year, Entity A uses the average rate as a practical approximation ([3.00 + 2.00] / 2 = 2.50, in accordance with paragraph 25 of PBE IPSAS 4). Therefore, while the fair value of the trading asset has increased by LCX130 (= LCX330 – LCX200), Entity A recognises only LCX25 (= LCY10 × 2.5) of this increase in consolidated surplus or deficit to comply with paragraph 44(b) of PBE IPSAS 41. The resulting exchange difference, i.e., the remaining increase in the fair value of the debt instrument (LCX130 – LCX25 = LCX105), is accumulated in other comprehensive revenue and expense until the disposal of the net investment in the foreign operation in accordance with paragraph 57 of PBE IPSAS 4.

E.2.3 PBE IPSAS 41 and PBE IPSAS 4—Interaction Between PBE IPSAS 41 and PBE IPSAS 4

PBE IPSAS 41 includes requirements about the measurement of financial assets and financial liabilities and the recognition of gains and losses on remeasurement in surplus or deficit. PBE IPSAS 4 includes rules about the reporting of foreign currency items and the recognition of exchange differences in surplus or deficit. In what order are PBE IPSAS 4 and PBE IPSAS 41 applied?

Statement of Financial Position

Generally, the measurement of a financial asset or financial liability at fair value or amortised cost is first determined in the foreign currency in which the item is denominated in accordance with PBE IPSAS 41. Then, the foreign currency amount is translated into the functional currency using the closing rate or a historical rate in accordance with PBE IPSAS 4 (paragraph AG224 of PBE IPSAS 41). For example, if a monetary financial asset (such as a debt instrument) is measured at amortised cost in accordance with PBE IPSAS 41, amortised cost is calculated in the currency of denomination of that financial asset. Then, the foreign currency amount is recognised using the closing rate in the entity's financial statements (paragraph 27 of PBE IPSAS 4). That applies regardless of whether a monetary item is measured at amortised cost or fair value in the foreign currency (paragraph 28 of PBE IPSAS 4). A non-monetary financial asset (such as an investment in an equity instrument) that is measured at fair value in the foreign currency is translated using the closing rate (paragraph 27(c) of PBE IPSAS 4).

As an exception, if the financial asset or financial liability is designated as a hedged item in a fair value hedge of the exposure to changes in foreign currency rates under PBE IPSAS 41 (or PBE IPSAS 29 *Financial Instruments: Recognition and Measurement* if an entity chooses as its accounting policy to continue to apply the hedge accounting requirements in PBE IPSAS 29), the hedged item is remeasured for changes in foreign currency rates even if it would otherwise have been recognised using a historical rate under PBE IPSAS 4 (paragraph 137 of PBE IPSAS 41 or paragraph 99 of PBE IPSAS 29), i.e., the foreign currency amount is recognised using the closing rate. This exception applies to non-monetary items that are carried in terms of historical cost in the foreign currency and are hedged against exposure to foreign currency rates (paragraph 27(b) of PBE IPSAS 4).

Surplus or Deficit

The recognition of a change in the carrying amount of a financial asset or financial liability in surplus or deficit depends on a number of factors, including whether it is an exchange difference or other change in carrying amount, whether it arises on a monetary item (for example, most debt instruments) or non-monetary item (such as most equity investments), whether the associated asset or liability is designated as a cash flow hedge of an exposure to changes in foreign currency rates, and whether it results from translating the financial statements of a foreign operation. The issue of recognising changes in the carrying amount of a financial asset or financial liability held by a foreign operation is addressed in a separate question (see Question E.2.2).

Any exchange difference arising on recognising *a monetary item* at a rate different from that at which it was initially recognised during the period, or recognised in previous financial statements, is recognised in surplus or deficit in accordance with PBE IPSAS 4 (paragraph AG224 of PBE IPSAS 41, paragraphs 32 and 37 of PBE IPSAS 41), unless the monetary item is designated as a cash flow hedge of a highly probable forecast transaction in foreign currency, in which case the requirements for recognition of gains and losses on cash flow hedges apply (paragraph 140 of PBE IPSAS 41 or paragraph 106 of PBE IPSAS 29). Differences arising from recognising a monetary item at a foreign currency amount different from that at which it was previously recognised are accounted for in a similar manner, since all changes in the carrying amount relating to foreign currency movements should be treated consistently. All other changes in the statement of financial position measurement of a monetary item are recognised in surplus or deficit in accordance with PBE IPSAS 41. For example, although an entity recognises gains and losses on financial assets measured at fair value through other comprehensive revenue and expense in other comprehensive revenue and expense (paragraphs 111 and AG225 of PBE IPSAS 41), the entity nevertheless recognises the changes in the carrying amount relating to changes in foreign exchange rates in surplus or deficit (paragraph 27(a) of PBE IPSAS 4).

Any changes in the carrying amount of a *non-monetary item* are recognised in surplus or deficit or in other comprehensive revenue and expense in accordance with PBE IPSAS 41. For example, for an investment in an equity instrument that is presented in accordance with paragraph 106 of PBE IPSAS 41, the entire change in the carrying amount, including the effect of changes in foreign currency rates, is presented in other comprehensive revenue and expense (paragraph AG226 of PBE IPSAS 41). If the non-monetary item is designated as a cash flow hedge of an unrecognised firm commitment or a highly probable forecast transaction in foreign currency, the requirements for recognition of gains and losses on cash flow hedges apply (paragraph 140 of PBE IPSAS 41 or paragraph 106 of PBE IPSAS 29).

When some portion of the change in carrying amount is recognised in other comprehensive revenue and expense and some portion is recognised in surplus or deficit, for example, if the amortised cost of a foreign currency bond measured at fair value through other comprehensive revenue and expense has increased in foreign currency (resulting in a gain in surplus or deficit) but its fair value has decreased in foreign currency (resulting in a loss recognised in other comprehensive revenue and expense), an entity cannot offset those two components for the purposes of determining gains or losses that should be recognised in surplus or deficit or in other comprehensive revenue and expense.

E.2.4—Valuation of Unquoted Equity Instruments

What valuation technique is most appropriate to apply when determining the fair value of these unquoted equity instruments?

Entities have a wide range of valuation techniques available when determining the fair value of an unquoted equity instrument. PBE IPSAS 41 does not prescribe the use of a specific valuation technique, but instead encourages the use of professional judgement and the consideration of all the facts and circumstances surrounding the section of an appropriate measurement technique. Figure 1 illustrates various valuations techniques that may be applicable based on the transactions facts and circumstances. This is not an exhaustive list.

Figure 1 – Valuation approaches and valuation techniques	
Valuation approach	Valuation techniques
Market approach	• Transaction price paid for an identical or similar instrument of an investee (see illustrative example 23) • Comparable company valuation multiples
Other approaches	• Discounted cash flow method (see illustrative example 24) • Dividend discount model • Constant growth model (see illustrative example 25) • Capitalisation model • Adjusted net asset method (see illustrative example 26)

The economic characteristics of unquoted equity instruments and the information that is reasonably available to an entity are two of the factors that should be considered when selecting the most appropriate valuation technique. For example, an entity is likely to place more emphasis on the comparable company valuation multiples technique when there are sufficiently comparable company peers or when the background or details of the observed transactions are known. Similarly, an entity is likely to place more emphasis on the discounted cash flow method when, for example:

(a) The cash flows of an entity present unique characteristics such as periods of unequal rates of growth (for example, a period of high growth that stabilises later to more steady levels of growth).

(b) Alternatively, when measuring the fair value of unquoted equity instruments, an entity might conclude that, on the basis of the specific facts and circumstances (for example, the nature of the investment, the history and stage of the development of the investment, the nature of the investment's assets and liabilities, its capital structure etc.).

(c) It is appropriate to apply the adjusted net asset method. Consequently, given specific facts and circumstances, one valuation technique might be more appropriate than another.

Some of the factors that an entity will need to consider when selecting the most appropriate valuation technique(s) include (this list is not exhaustive):

1. The information that is reasonably available to an entity;
2. The market conditions;
3. The investment horizon and investment type (for example, the market sentiment when measuring the fair value of a short-term financial investment might be better captured by some valuation techniques than by others);
4. The life cycle of the investment (i.e., what may trigger value in different stages of an entity's life cycle might be better captured by some valuation techniques than by others);
5. The nature of an investment's business (for example, the volatile or cyclical nature of an investee's business might be better captured by some valuation techniques than others); and
6. The industry in which an entity operates.

The fair value measurement technique must reflect current market conditions. An entity might ensure that the valuation techniques reflect current market conditions by calibrating them at the measurement date. At initial recognition, if the transaction price represented fair value and an investor will use a valuation technique to measure fair value in subsequent periods that uses unobservable inputs, the entity must calibrate the valuation technique so that it equals the transaction price (if the transaction contains a non-exchange component, recalibrate to the fair value of the equity instrument). The use of calibration when measuring the fair value of the unquoted equity instruments at the measurement date is a good exercise for an entity to ensure that the valuation technique reflects current market conditions and to determine whether an adjustment to the valuation technique is necessary (for example, there might be a characteristic of the instrument that is not captured by the valuation technique or a new fact that has arisen at the measurement date that was not present at initial recognition).

In some circumstances, an entity may have to apply more than one valuation technique when determining fair value.

Examples of various types of techniques for measurement of the fair value of unquoted equity instruments are provided in Illustrative Examples 23–26.

E.2.5—Cost as a Proxy for Fair Value of Equity Instruments

Can the cost of the equity instrument be used by default for subsequent measurement?

No. Investments in equity instruments must be measured at fair value. However, as noted in paragraph AG140 cost may be an appropriate estimate of fair value because there is insufficient recent information available to measure fair value or because there is a wide range of possible fair value measurements and cost represents the best estimate of fair value within that range.

Section F Other

F.1 PBE IPSAS 41 and PBE IPSAS 2—Hedge Accounting: Cash Flow Statements

How should cash flows arising from hedging instruments be classified in cash flow statements?

Cash flows arising from hedging instruments are classified as operating, investing or financing activities, on the basis of the classification of the cash flows arising from the hedged item. While the terminology in PBE IPSAS 2 *Cash Flow Statements* has not been updated to reflect PBE IPSAS 41, the classification of cash flows arising from hedging instruments in the cash flow statement should be consistent with the classification of these instruments as hedging instruments under PBE IPSAS 41.

Section G Concessionary Loans and Non-Exchange Equity Transactions

G.1 Sequencing of 'Solely Payments of Principal and Interest' Evaluation for a Concessionary Loan

If an entity issues a concessionary loan (financial asset) when does it assess classification for subsequent measurement purposes?

An entity firstly assesses whether the substance of the concessionary loan is in fact a loan, a grant, a contribution from owners or a combination thereof, by applying the principles in PBE IPSAS 28 and paragraphs 42–58 of PBE IPSAS 23 *Revenue from Non-Exchange Transactions*. If an entity has determined that the transaction, or part of the transaction, is a loan, it assesses whether the transaction price represents the fair value of the loan on initial recognition. An entity determines the fair value of the loan by using the principles in paragraphs AG144–AG155. After initial recognition at fair value, an entity subsequently assesses the classification of concessionary loans in accordance with paragraphs 39–44 and measures concessionary loans in accordance with paragraphs 61–65.

G.2 Concessionary Loans and 'Solely Payments of Principal and Interest' Evaluation

Can a concessionary loan satisfy the SPPI condition?

Yes. When the payments of the loan, based on its fair value determined at initial recognition, reflect solely payments of principal and interest.

However, if a financial asset contains a contractual term that could change the timing or amount of contractual cash flows (for example, a contingent repayment feature specific to the borrower), 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. 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 40(b) and 41(b). 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 (i.e., the trigger) that would change the timing or amount of the contractual cash flows (see paragraphs AG72–AG75).

A common feature of a concessionary loan is an interest concession. A concessionary loan with a contractual interest rate of nil does not preclude the instrument from satisfying the SPPI condition.

G.3 Valuation of Non-Exchange Component

Can the non-exchange component of an equity transaction equal the transaction cost?

No. To the extent an entity receives an equity instrument, such as common shares, in exchange for consideration, the equity instrument will have some value on initial recognition and must be measured at fair value.

At initial recognition, the entity must evaluate the substance of the arrangement and assess whether a portion of the consideration provided is a non-exchange component such as a grant or subsidy.

G.4 Equity Instruments Arising from Non-Exchange Transactions

How might an equity instrument included in a non-exchange transaction be evidenced?

In assessing whether an equity instrument is included as part of a transaction that also includes a non-exchange component, an entity applies the definition of an equity instrument and the requirements in PBE IPSAS 28.

Indicators that may evidence the existence of an equity instrument may include:

(a) A formal designation of the transfer (or a class of such transfers) of equity instruments forming part of the investment's contributed net assets/equity, either before the investment occurs or at the time of the investment;

(b) A formal agreement, in relation to the equity instrument, establishing or increasing an existing financial interest in the net assets/equity of the investment that can be sold, transferred, or redeemed; or

(c) The receipt of equity instruments that can be sold, transferred, or redeemed.

G.5 Factors to consider in evaluating concessionary and originated credit-impaired loans

What factors should be considered when evaluating whether a loan is a concessionary loan or an originated credit-impaired loan?

Both concessionary loans and originated credit-impaired loans have lower estimated future cash flows than similar loans that do not have a concessionary or credit-impaired component.

The issuer of a debt instrument evaluates the substance of the financial instrument to determine whether the instrument is classified as a concessionary loan or an originated credit-impaired loan.

Features that indicate that the financial instrument is a concessionary loan include:

- The lender has an objective to incorporate a non-exchange component in the loan transaction. As such, the lender intends to give up a portion of the cash flows that would otherwise be available had the transaction been negotiated at market terms;
- The financial instrument is extended below-market terms, by way of an interest and/or a principal concession; and
- The characteristics of the loan agreement, i.e., the contractual terms that are negotiated off market, result in a decrease in the estimated future cash flows of the instrument when compared to a similar loan that does not have a concessionary or credit-impaired component.

Originated credit-impaired financial assets (see paragraphs 85–86) are generally extended at market terms at origination but have lower estimated cash flows in comparison to similar instruments, because the borrowing entity is not expected to be able to satisfy the contractual terms of the arrangement. The lender expects a portion of the contractual cash flows to be uncollectible, as opposed to intending to give up a portion of the cash flows which would otherwise be available at market terms. As such, originated credit-impaired loans present an opportunity for the lender to collect cash flows in excess of the estimated future cash flows, while with concessionary loans, the estimated future cash flows approximate the contractual cash flows, meaning no additional cash flows are available.

G.6 Concessionary loans that are originated credit-impaired

Can a concessionary loan be originated credit-impaired?

Yes. In some circumstances a concessionary loan may be granted that is also originated credit-impaired. A concessionary loan may be credit-impaired at origination because one or more events have had a detrimental impact on the estimated future cash flows of the financial asset.

For example, in order to support the operation of the national airline's domestic routes, the department of finance advances loans to the airline on an annual basis. The annual interest payments are based on a contract rate of 6 per cent. Assuming the market rate at the time the loan is advanced is 10 per cent, this represents a concession.

Historically, even with the concessionary terms, the department of finance has collected only 85 per cent of the loan's contractual cash flows. The department of finance expects this trend to continue with the current loan issue.

This example represents a concessionary originated credit-impaired loan as the loan has concessionary terms, but even with those terms, significant credit losses are expected to occur.

In evaluating whether the expected credit losses on the concessionary loan support the loan being originated credit-impaired or just represent normal credit losses, the entity considers whether one or more events has occurred that have had a detrimental impact on the estimated future cash flows of the loan.

Section H Effective Interest Method

H.1 Requirement to Use the Effective Interest Method

When transaction costs and any premium or discount on issuance are insignificant, measuring the amortised cost of an instrument using the effective interest rate produces similar results as using the straight-line method.

In circumstances where measuring the gross amount of an instrument using the effective interest method yields immaterial differences as compared to applying the straight-line method, is the effective interest method required to be used?

Measuring the amortised cost of an instrument requires the use of the effective interest method. However, in practice there may be scenarios where applying the straight-line method yields materially the same result.

Paragraph 10 of PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors*, indicates "PBE Standards set out accounting policies that the NZASB has concluded result in financial statements of public benefit entities containing relevant and faithfully representative information about the transactions, other events, and conditions to which they apply. Those policies need not be applied when the effect of applying them is immaterial. …"

When an alternative technique – in this case the straight-line method – yields materially the same result as measuring amortised cost using the effective interest method, management need not apply the effective interest method as required by PBE IPSAS 41.

The following example illustrates why differences arise when measuring the gross amount of a debt instrument using the effective interest method compared to the straight-line method. National Government A issues a bond with a face value of CU100,000. The bond yield of 10 per cent is paid annually until maturity in 5 years. The bond was issued at a discount of 3 per cent and National Government A had to pay CU2,000 in transaction costs.

Under both measurement methodologies, National Government A received CU95,000 on issuance of the instrument (CU95,000 = CU100,000 – CU2,000 – CU100,000 x 3 per cent).

Straight-Line Method

Measuring the gross amount of the instrument using the straight-line method requires amortising the discount and transaction costs evenly until maturity.

Year	(a) Gross carrying amount at the beginning of the year	(b = 100,000 × 10 per cent) Interest expense	(c) Amortisation of transaction costs and discount	(d) Cash flows	(e = a + b + c – d) Gross carrying amount at the end of the year
1	95,000	10,000	1,000	10,000	96,000
2	96,000	10,000	1,000	10,000	97,000
3	97,000	10,000	1,000	10,000	98,000
4	98,000	10,000	1,000	10,000	99,000
5	99,000	10,000	1,000	110,000	–

Effective Interest Method

Measuring the gross amount of the instrument using the effective interest method requires calculating the rate that exactly discounts the estimate future cash payments through the expected life of the instrument to the gross carrying amount of the instrument. Discounting the estimated cash flows of the bond yields an effective interest rate of 11.37 per cent.

Year	(a)	(b = a × 11.37 per cent)	(c)	(d = a + b – c)
	Gross carrying amount at the beginning of the year	Interest expense	Cash flows	Gross carrying amount at the end of the year
1	95,000	10,797	10,000	95,797
2	95,797	10,888	10,000	96,685
3	96,685	10,989	10,000	97,673
4	97,673	11,101	10,000	98,774
5	98,774	11,226	110,000	–

When evaluating whether measuring the gross amount of the bond using the straight-line method yields an immaterial difference compared to applying the effective interest method, the gross amount is compared at each measurement date as detailed in the table below.

Year	Straight-Line Method	Effective Interest Method	
	Gross carrying amount at the beginning of the year	Gross carrying amount at the beginning of the year	Difference
1	95,000	95,000	-
2	96,000	95,797	203
3	97,000	96,685	315
4	98,000	97,673	327
5	99,000	98,774	226

The measurement difference between the two methods is a result of the transaction costs and the discount on issuance of the bond. As the costs approach zero, the difference between measuring the bond using the straight-line method or the effective interest method will become smaller. As the costs increase, the difference will grow in size.

Furthermore, contemplating the effect on annual interest expense may yield further considerations when assessing whether applying the straight-line method or effective interest method is material.

Section I Sovereign Debt Restructurings

I.1 Sovereign Debt Restructurings

Are sovereign debt restructurings covered by PBE IPSAS 41?

Yes. Sovereign debt restructurings involve the modification, and/or derecognition, of financial liabilities, which are addressed in PBE IPSAS 41. The requirements and guidance relevant to sovereign debt restructurings include:

(a) Paragraphs 57 and 64 establish the requirements for the initial, and subsequent, measurement of financial liabilities;

(b) Paragraphs 35–38 establish the derecognition requirements for financial liabilities;

(c) Paragraph AG46 provides application guidance for assessing the extent of modifications to financial liabilities; and

(d) Paragraphs AG118–AG127 provide application guidance for loans granted at concessionary terms.

Comparison with IPSAS 41

PBE IPSAS 41 *Financial Instruments* is drawn from IPSAS 41 *Financial Instruments.*

The significant differences between PBE IPSAS 41 and IPSAS 41 are:

(a) PBE IPSAS 41, Appendix D *Amendments to Other Standards*, included more extensive amendments to PBE IPSAS 9 *Revenue from Exchange Transactions*. These amendments were required to align with the requirements on interest and dividend revenue in PBE IPSAS 41.

(b) PBE Standards require the presentation of a statement of comprehensive revenue and expense. IPSASs require the presentation of a statement of financial performance.

History of Amendments

Table of Pronouncements – PBE IPSAS 41 *Financial Instruments*

This table lists the pronouncements establishing and substantially amending PBE IPSAS 41.

Pronouncements	**Date approved**	**Early operative date**	**Effective date (annual reporting periods… on or after …)**
PBE IPSAS 41 *Financial Instruments*	March 2019	Early application permitted	1 Jan 2022

EFFECTIVE DATE OF PBE IFRS 9

Issued March 2019

This Standard was issued on 28 March 2019 by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 12(a) of the Financial Reporting Act 2013.

This Standard is a disallowable instrument for the purposes of the Legislation Act 2012, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on 25 April 2019.

Reporting entities that are subject to this Standard are required to apply it in accordance with the effective date, which is set out in Part C.

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.

This Standard has been issued to defer the effective date of PBE IFRS 9 *Financial Instruments* from annual reporting periods beginning on or after 1 January 2021 to 1 January 2022. Following the issuance of PBE IPSAS 41 *Financial Instruments*, which supersedes PBE IFRS 9, this Standard also limits the ability of an entity to early adopt PBE IFRS 9. An entity may elect to apply PBE IFRS 9 if, and only if, the entity's date of initial application is before 1 January 2020.

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CONTENTS

Part A: Scope

This Standard applies to Tier 1 and Tier 2 public benefit entities.

Part B: Amendments to PBE IFRS 9 *Financial Instruments*

On the front cover of PBE IFRS 9 a text box is added. This text box is not a formal amendment to the standard. It is shown here for information.

This Standard is superseded by PBE IPSAS 41 *Financial Instruments* issued in March 2019. An entity may elect to apply this Standard if, and only if, the entity's date of initial application is before 1 January 2020.

Paragraph 7.1.1 is amended and paragraph 7.1.7 is added. Deleted text is struck through and new text is underlined.

7.1 Effective date

7.1.1 An entity shall apply this Standard for annual periods beginning on or after 1 January 2022~~2021~~. Earlier application is permitted if, and only if, the entity's date of initial application is before 1 January 2020. If an entity elects to apply this Standard early, it must disclose that fact and apply all of the requirements in this Standard at the same time (but see also paragraph 7.2.21). It shall also, at the same time, apply the amendments in Appendix D.

…

7.1.7 *Effective Date of PBE IFRS 9*, issued in March 2019, amended paragraph 7.1.1. An entity shall apply that amendment for annual periods beginning on or after 1 January 2020.

Paragraph BC20 and the related heading are added. New text is underlined. Paragraph BC19 is shown for ease of reading.

Basis for Conclusions

…

Effective date

BC19. The NZASB issued PBE IFRS 9 in January 2017 with an effective date of annual periods beginning on or after 1 January 2021. The NZASB aligned the effective date of PBE IFRS 9 with its best estimate of the effective date of new and revised IPSASs dealing with financial instruments. This was to allow PBEs, in particular those that do not face mixed group issues, to defer adoption of the new requirements for financial instruments until the IPSASB has completed its project to revise its financial instruments standards and the NZASB has applied the PBE Policy Approach to those new and revised standards. Respondents were supportive of the delayed effective date. The NZASB noted that this could result in different PBEs applying different financial instrument standards for some time. The NZASB agreed to monitor the IPSASB's project and reconsider the effective date of this Standard if required.

Deferral of effective date

BC20. The IPSASB issued IPSAS 41 *Financial Instruments*, which is based on IFRS 9, in August 2018. Following the issue of IPSAS 41, the NZASB agreed to develop a new PBE Standard based on IPSAS 41 and to withdraw PBE IFRS 9. In order to ensure that PBE IFRS 9 did not become mandatorily effective before PBE IPSAS 41 the NZASB proposed to defer the effective date of PBE IFRS 9 by one year, from 1 January 2021 to 1 January 2022. NZASB ED 2018-6 *Effective Date of PBE IFRS 9*, issued in November 2018, also proposed to permit entities to early-adopt PBE IFRS 9 for a limited period ~~(six months)~~ following the issue of the proposed PBE IPSAS 41 *Financial Instruments*. The NZASB noted that the

IASB also allowed a limited period ~~similar period~~ of time for entities that were in the process of adopting earlier versions of IFRS 9 when ~~at the time that~~ IFRS 9 (2014) was issued. Respondents agreed with the proposals. The NZASB subsequently issued PBE IPSAS 41 *Financial Instruments* and *Effective Date of PBE IFRS 9* in March 2019.

In Appendix D *Amendments to Other Standards* the amendments to PBE FRS 47 are further amended. A footnote is added to paragraph E1. New text is underlined.

PBE FRS 47 *First-time Adoption of PBE Standards by Entities Other than those Previously Applying NZ IFRS*

…

Short-term exemptions from PBE Standards

E1. If an entity's first PBE Standards reporting period begins before 1 January 2021 and the entity applies PBE IFRS 9 *Financial Instruments*,* the comparative information in the entity's first set of financial statements under PBE Standards need not comply with PBE IPSAS 30 *Financial Instruments: Disclosures* or PBE IFRS 9, to the extent that the disclosures required by PBE IPSAS 30 relate to items within the scope of PBE IFRS 9. For such entities, references to the 'date of transition to PBE Standards' shall mean, in the case of PBE IPSAS 30 and PBE IFRS 9 only, the beginning of the first reporting period under PBE Standards.

* *Effective Date of PBE IFRS 9*, issued in March 2019, deferred the effective date of PBE IFRS 9 from 1 January 2021 to 1 January 2022.

Part C: Effective date

This Standard is effective for annual financial statements beginning on or after 1 January 2020.

NZ ACCOUNTING STANDARDS BOARD

Memorandum

Date:	20 March 2019
To:	Graeme Mitchell, External Reporting Board
From:	Kimberley Crook, Chair NZASB
Subject:	PBE IPSAS 41 *Financial Instruments* and *Effective Date of PBE IFRS 9*

Introduction[1]

1. In accordance with the protocols established by the XRB Board, the NZASB seeks your approval to issue PBE IPSAS 41 *Financial Instruments* and *Effective Date of PBE IFRS 9*.

2. PBE IPSAS 41 contains updated recognition and measurement requirements for financial instruments and is aligned with the most recent international standards: IFRS 9 *Financial Instruments* and IPSAS 41 *Financial Instruments*. PBE IPSAS 41 will supersede PBE IFRS 9 *Financial Instruments* which was issued as an interim standard to address mixed group issues, pending the development of IPSAS 41 by the IPSASB. It will also supersede most of PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*, apart from the hedging requirements which remain available as an option.

3. *Effective Date of PBE IFRS 9* is an amending standard which will defer the mandatory effective date of PBE IFRS 9 by a year so that it does not become mandatorily effective before PBE IPSAS 41. It will also limit the ability of PBEs to early adopt PBE IFRS 9, given it will be superseded by PBE IPSAS 41.

Due process

4. The due process for the proposed PBE IPSAS 41 has occurred in three phases.
   (a) Development of PBE IFRS 9 (during 2016).
   (b) Development of IPSAS 41 (during 2017/2018).
   (c) Development of PBE IPSAS 41 (during 2018/2019).

5. Prior to this there was been extensive due process associated with the development of IFRS 9 by the IASB. PBE IFRS 9, IPSAS 41 and PBE IPSAS 41 are all based on IFRS 9.

<u>Development of PBE IFRS 9</u>

6. Following discussions with constituents about the likely impact on mixed groups of the differences between NZ IFRS 9 *Financial Instruments* and the then current PBE Standard,

[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® Standards, IFRIC® Interpretations and IASB® papers).

PBE IPSAS 29, the NZASB decided to issue an exposure draft of a PBE Standard based on IFRS 9. The intention was to address the most significant mixed group issues, not to completely align PBE Standards with NZ IFRS.

7. The NZASB issued ED 2016-7 PBE IFRS 9 *Financial Instruments* in June 2016. Comments were due by 30 September 2016. During the comment period the NZASB held roundtables to seek feedback on the ED. The NZASB also received seven comment letters on the ED.

8. The main issue raised by respondents in 2016 was the application of the proposed standard to concessionary loans and, in particular, student loans. Two constituents suggested that the NZASB allow entities to continue their current method of accounting for concessionary loans or provide additional guidance on how to apply the proposed standard to concessionary loans. The NZASB decided not to modify the scope, classification or subsequent measurement requirements in PBE IFRS 9. In coming to this decision the Board reflected on the objective of the project, the risks of developing a PBE Standard in advance of the IPSASB and the possibility of unintended consequences if it were to modify the requirements. IPSASB staff were kept informed of the NZASB's deliberations.

9. The NZASB approved PBE IFRS 9 in December 2016 and it was issued in January 2017. It was available for early adoption but did not become effective for all PBEs until periods beginning on or after 1 January 2021. PBEs have had the option of adopting PBE IFRS 9 or continuing to apply PBE IPSAS 29. PBE IFRS 9 is currently being applied by the Government of New Zealand and a few other PBEs. There is therefore a high level of awareness of the requirements of PBE IFRS 9 in the public sector.

10. The signing memo that accompanied PBE IFRS 9 stated that the effective date of PBE IFRS 9 had deliberately been set for some time in the future to allow for the completion of the IPSASB's project and consideration of a future IPSAS by the NZASB and public benefit entities in New Zealand. It also said that the NZASB planned to review the effective date of PBE IFRS 9 once the IPSASB had completed its project.

Development of IPSAS 41

11. The IPSASB issued ED 62 *Financial Instruments* in August 2017 and IPSAS 41 in August 2018. The IPSASB received 22 comment letters, including one from the NZASB. NZASB staff closely monitored the development of IPSAS 41.

12. IPSAS 41 is closely aligned with IFRS 9. In addition to carrying forward previous public sector modifications in IPSAS 29 *Financial Instruments: Recognition and Measurement* the IPSASB made relatively few additional public sector specific modifications. Some of the modifications related to concessionary loans. The IPSASB included guidance on distinguishing between concessionary loans and credit-impaired loans. It also required that in the case of a concessionary loan that is also originated credit-impaired, both the credit losses and the concessionary element are recognised as a concession.

Development of PBE IPSAS 41

13. The NZASB issued ED 2018-5 PBE IPSAS 41 *Financial Instruments* and ED 2018-6 *Effective Date of PBE IFRS 9* in November 2018. Comments were due by 28 February 2019.

14. The Invitation to Comment that accompanied the EDs outlined the main differences between the proposed PBE IPSAS 41 and (i) PBE IPSAS 29; (ii) PBE IFRS 9 and (iii) IPSAS 41. A marked-up copy of the ED (which was made available on the XRB's website) also identified differences between the proposed PBE IPSAS 41 and (i) IFRS 9 and (ii) PBE IFRS 9.

15. Staff notified a number of constituents about the proposals.
    (a) The EDs were highlighted at the Experienced Finance Professionals[2] (EFP) forum for the state sector. A notice was placed on the EFP forum intranet.
    (b) Charities Services was advised of the proposals and placed a notice about the EDs on its website.
    (c) Audit New Zealand, the Reserve Bank of New Zealand, the New Zealand Society of Local Government Managers, Local Government New Zealand, and a number of the larger local authorities (16) were notified about the proposals.
    (d) A recorded webinar was made available on the XRB website.

16. The NZASB received three supportive comment letters. One respondent recommended that the NZASB add a transitional provision to avoid undue cost and effort for entities transitioning from PBE IPSAS 29 in relation to the initial measurement of financial guarantee contracts issued through non-exchange transactions whose fair value cannot be reliably determined. The NZASB agreed and added a transition provision to reduce the effort required by entities with such financial guarantee contracts.

<u>Due process: concluding comments</u>

17. 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.

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

Proposed effective dates

19. PBE IPSAS 41 will be mandatory for Tier 1 and Tier 2 public benefit entities from 1 January 2022, with early adoption permitted. This proposed effective date aligns with the effective date of IPSAS 41. Entities that have already early adopted PBE IFRS 9 have a few more years before they are required to move to PBE IPSAS 41. Entities that are still applying PBE IPSAS 29 will need to reclassify their financial instruments and apply the new recognition and measurement requirements when they move to PBE IPSAS 41. For some this will be a significant task. However, respondents indicated that the effective date was appropriate.

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[2] This is a forum organised by Treasury for finance professionals in the state sector to share knowledge of relevant topics.

20. *Effective Date of PBE IFRS 9* delays the effective date of PBE IFRS 9 by one year, from 1 January 2021 to 1 January 2022. This is to prevent PBE IFRS 9 from becoming mandatory before the effective date of PBE IPSAS 41.

Consistency with XRB Financial Reporting Strategy

21. The proposed PBE IPSAS 41 is consistent with the Financial Reporting Strategy as set out in the Accounting Standards Framework. The development of PBE IFRS 9 did not represent our usual approach to developing PBE Standards but reflected feedback from New Zealand constituents that the compliance costs associated with having different requirements in NZ IFRS and PBE Standards and the desirability of the higher quality reporting requirements in NZ IFRS 9 justified the development of a PBE Standard in advance of the IPSASB.

22. There are no Reduced Disclosure Regime (RDR) concessions in PBE IPSAS 41. However, the Standard amends the disclosure requirements in other standards, especially PBE IPSAS 30 *Financial Instruments: Disclosures*. The RDR concessions for the new disclosure requirements in PBE IPSAS 30 have been aligned with the existing for-profit concessions in NZ IFRS 7 *Financial Instruments: Disclosures,* as amended by NZ IFRS 9. They are expected to be reviewed once the NZASB has completed its review of the for-profit disclosure concessions.

Other matters

23. There are no other matters relating to the issue of PBE IPSAS 41 or *Effective Date of PBE IFRS 9* that the NZASB considers to be pertinent or that should be drawn to your attention.

Recommendations

24. The NZASB recommends that you sign the attached certificates of determination on behalf of the XRB Board.

Attachments

PBE IPSAS 41 *Financial Instruments*

Effective Date of PBE IFRS 9

Kimberley Crook
Chair NZASB

NZ ACCOUNTING STANDARDS BOARD

Memorandum

Date:	8 March 2019
To:	NZASB Members
From:	Tracey Crookston
Subject:	**Annual Review of Application of the PBE Policy Approach**

Purpose and Introduction[1]

1. The purpose of this agenda item is to give the Board the opportunity to review and confirm its previous decisions regarding the application of the *Policy Approach to Developing the Suite of PBE Standards* (PBE Policy Approach).[2]

2. The Board applies the PBE Policy Approach to:

   (a) new or amending IFRS Standards and decides whether to incorporate the new standard or amendment into the PBE Standards or wait for the IPSASB to consider the pronouncement. The PBE Policy Approach is applied when the new or amending IFRS Standard is approved by the Board for issue in New Zealand; and

   (b) new or amending IPSASs. There is a rebuttable assumption that these will be incorporated into the PBE Standards. The PBE Policy Approach is applied when the IPSASB issues the new or amending IPSAS.

3. The agenda provides an annual update, at a point in time, which pronouncements issued by the IASB or the IPSASB are yet to be incorporated into the PBE Standards. The update includes a summary of the current status of applying the PBE Policy Approach together with staff recommendations.

Recommendations[3]

4. The Board is asked to

   (a) REVIEW the application of the PBE Policy Approach; and

   (b) AGREE the recommendations set out in the summary table on page 2.

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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® Standards, IFRIC® Interpretations and IASB® papers).

2 The PBE Policy Approach was last updated by the Board in December 2018.

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

IASB pronouncements not included in PBE Standards	**We recommend that the Board:**
Revenue	
IFRS 15 *Revenue from Contracts with Customers*	AGREES to wait for the IPSASB to complete its revenue project and then apply the PBE Policy Approach to the IPSASB's new and revised revenue standards.
Clarifications to NZ IFRS 15 Revenue from Contracts with Customers	
Leases	
IFRS 16 *Leases*	NOTES the discussion on PBE Leases in agenda item 2.6.2
Interests in Other Entities	
Sale or Contribution of Assets Between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28)	AGREES to continue to MONITOR the IASB's research project on the equity method.
Effective Date of Amendments to IFRS 10 and IAS 28	
Insurance Contracts	
IFRS 17 *Insurance Contracts*	NOTES that ED PBE IFRS 17 *Insurance Contracts* is currently out on exposure.
Other	
Other IASB Pronouncements	NOTES the status of the other IASB pronouncements that have not yet been incorporated into the PBE Standards (refer to page 7 of the memo).
IPSASB Pronouncements not included in PBE Standards	**We recommend that the Board:**
Financial Instruments	
IPSAS 41 *Financial Instruments*	NOTES that PBE IPSAS 41 *Financial Instruments* is in the process of finalisation for issue.
Public Sector Combinations	
IPSAS 40 *Public Sector Combinations*	NOTES that PBE IPSAS 40 *PBE Combinations* is in the process of finalisation for issue.
Social Benefits	
IPSAS 42 *Social Benefits*	NOTES that it has AGREED to DEFER its decision to develop a PBE Standard based on IPSAS 42 *Social Benefits* until the IPSASB has completed other related projects dealing with non-exchange expenses.
Other	
Other IPSASB Pronouncement	NOTES the status of the other IPSASB pronouncement that has not yet been incorporated into the PBE Standards (refer to page 10 of the memo).

Background

Applying the PBE Policy Approach and Monitoring

5. Since 1 October 2013 the Board has applied the PBE Policy Approach to pronouncements that have been issued by both the IASB and the IPSASB. The pronouncement may be a new IFRS or IPSAS or a change to an existing IFRS or IPSAS.

6. For pronouncements issued by the IASB, the Board must decide whether to make a change to the PBE Standards, or whether to wait for the IPSASB to consider the IASB pronouncement for inclusion in the respective IPSASs.

7. The Board monitors pronouncements issued by the IASB but not yet considered by the IPSASB. We track these pronouncements and bring a summary to the Board at regular intervals so the Board can review its earlier decisions and monitor ongoing projects.

Staff Tracking Tables

8. Staff maintain tracking tables to ensure that the PBE Policy Approach has been applied to all pronouncements issued by the IASB and the IPSASB since 1 October 2013.

9. The staff tracking tables have not been included in the agenda papers as they are quite large and detailed. They are available on request from staff.

Structure of this memo

10. The remainder of this memo provides further information about firstly IASB pronouncements and secondly IPSASB pronouncements that are yet to be incorporated into the PBE Standards, together with recommendations for the Board (as summarised on page 2).

A. IASB Pronouncements

Revenue

11. In the table below we have summarised the IASB pronouncements issued as NZ IFRSs that relate to revenue that have not been incorporated into the PBE Standards.

NZASB Approval and Date	IASB Pronouncement
Approval 44 – June 2014	IFRS 15 *Revenue from Contracts with Customers*
Approval 71 – May 2016	*Clarifications to IFRS 15* Revenue from Contracts with Customers

12. In June 2014, the NZASB issued NZ IFRS 15 *Revenue from Contracts with Customers*. In August 2014, the Board agreed that IFRS 15 should not be incorporated into the PBE Standards at that time.

13. The IPSASB has an active project on revenue. The project covers all types of revenue, both exchange and non-exchange. In late 2017, the Board commented on IPSASB Consultation Paper *Revenue and Non-Exchange Expenses*. The IPSASB has revenue as an item for discussion at its March 2019 meeting.

> ***Recommendation***
> We recommend that the Board AGREES to wait for the IPSASB to complete its revenue project and then apply the PBE Policy Approach to the IPSASB's new and revised revenue standards.

Leases

14. In the table below we have summarised the IASB pronouncements issued as NZ IFRSs that relate to leases that have not been incorporated into the PBE Standards.

NZASB Approval and Date	**IASB Pronouncement**
Approval 68 – February 2016	IFRS 16 *Leases*

15. The IASB issued IFRS 16 *Leases* in January 2016. The Board approved and issued NZ IFRS 16 *Leases* in February 2016.

16. At its March, August and November 2016 meetings, the Board considered whether to develop a PBE Standard based on IFRS 16 ahead of the IPSASB. Outreach was also undertaken during this time to assist the Board with its considerations. On balance, the Board agreed not to develop a PBE Standard based on IFRS 16. However, the Board agreed to continue to closely monitor the IPSASB's project on leases.

17. The IPSASB issued ED 64 *Leases* with a comment period ending 30 June 2018. The Board submitted a comment letter to the IPSASB. The IPSASB has leases as an item for discussion at its March 2019 meeting. At this stage, the IPSASB anticipates issuing a standard on leases in March 2020.

> ***Recommendation***
> We recommend the Board NOTES the discussion on PBE Leases in agenda item 2.6.2.

Interests in Other Entities

18. In December 2016, the Board approved for issue five PBE Standards dealing with interests in other entities, including PBE IPSAS 35 *Consolidated Financial Statements* and PBE IPSAS 36 *Investments in Associates and Joint Ventures.* These new PBE Standards incorporated most of the IASB's narrow scope amendments on these topics.

19. In the table below we have summarised the IASB pronouncements issued as NZ IFRSs that relate to interests in other entities that have not been incorporated in the PBE Standards.

NZASB Approval and Date	**IASB Pronouncement**
Approval 54 – October 2014	*Sale or Contribution of Assets Between an Investor and its Associate or Joint Venture* (Amendments to IFRS 10 and IAS 28)
Approval 67 – February 2016	*Effective Date of Amendments to IFRS 10 and IAS 28*

20. The narrow scope amendments to NZ IFRS 10 and NZ IAS 28 established the requirements for the recognition of a partial gain or loss for transactions between an investor and its associate or joint venture dependent on whether the sale or contribution of assets constitutes a business as defined in NZ IFRS 3 *Business Combinations.*

21. In December 2015, the IASB deferred the effective date of these amendments indefinitely, pending further research in this area as part of its research project on the equity method.[4] The IASB did not want to force entities to change their accounting twice in a short period. The amendments remained available for early adoption. In New Zealand, in the for-profit sector, the Board deferred the effective date of these amendments until 1 January 2020.[5]

22. The IPSASB did not incorporate these requirements in IPSAS 35 *Consolidated Financial Statements* or IPSAS 36 *Investments in Associates and Joint Ventures* because the IPSASB, at that stage, had not developed a standard dealing with combinations of entities.

23. The Board considered incorporating these amendments in PBE IPSAS 35 *Consolidated Financial Statements* and PBE IPSAS 36 *Investments in Associates.* However, following the IASB's decision to defer the effective date of these amendments indefinitely, the Board decided not to incorporate these amendments.

24. The IPSASB has since issued IPSAS 40 *Public Sector Combinations* (January 2017). The IPSASB considered the IASB's amendments to IFRS 10 and IAS 28 as part of its project on IPSAS 40. The IPSASB has now incorporated equivalent amendments to IPSAS 35 and IPSAS 36 (via consequential amendments in IPSAS 40). These amendments are to be applied from a date to be determined by the IPSASB.

25. In developing PBE IPSAS 40 *PBE Combinations* the Board reconsidered incorporating amendments in PBE IPSAS 35 and PBE IPSAS 36. However, given the IASB's 2016 decision to defer work on its equity method research project until it has undertaken post-implementation decision reviews of certain standards, the Board decided not to incorporate these amendments.

4 In May 2016 the IASB deferred further work on the equity method project until the Post-implementation Reviews (PiR) of IFRS 10 *Consolidated Financial Statements,* IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities* are undertaken. As part of the PiR for these standards, the IASB has decided to seek feedback on investors' information needs regarding investments accounted for using the equity method. The PiR of IFRS 10 and IFRS 12 are noted as forthcoming PiRs on the IASB's website.

5 The Board's workplan includes an item for the 2 May 2019 Board meeting to extend this effective date.

Recommendation
We recommend that the Board AGREES to continue to MONITOR the IASB's research project on the equity method.

Insurance contracts

26. In the table below we have summarised the IASB pronouncements issued as NZ IFRSs that relate to Insurance contracts that have not been incorporated into the PBE Standards.

NZASB Approval and Date	**IASB Pronouncement**
Approval 90 – August 2017	IFRS 17 *Insurance Contracts*

27. At its August 2017 meeting, the Board approved for issue NZ IFRS 17 *Insurance Contracts.* NZ IFRS 17 supersedes NZ IFRS 4 which is the basis for PBE IFRS 4 *Insurance Contracts.*

28. At this point, the IPSASB does not have an equivalent standard on insurance and has no plans to develop a standard.

29. At the February 2018 meeting, the PBE Policy Approach was applied to NZ IFRS 17. The Board agreed to develop a PBE Standard based on IFRS 17 *Insurance Contracts.* ED PBE IFRS 17 *Insurance Contracts* (the ED) was issued by the Board in December 2018.

30. The proposals in the ED are based on the requirements in IFRS 17 *Insurance Contracts.* However, the Board is proposing to amend the scope of the standard to capture certain schemes.[6] This is to ensure consistency with the IPSASB standard IPSAS 42 *Social Benefits* which allows the use of the insurance approach for certain schemes. IPSAS 42 requires an entity that chooses to adopt the insurance approach to comply with the relevant national or international accounting standard on insurance contracts.

31. Comments are due on the ED by 17 May 2019.

Recommendation
We recommend that the Board NOTES that ED PBE IFRS 17 *Insurance Contracts* is currently out on exposure.

[6] The scope of the ED has been amended to capture schemes:
(a) that are intended to be fully funded from contributions and levies; and
(b) where there is evidence that the entity manages the scheme in the same way as an issuer of insurance contracts, including assessing the financial performance and financial position of the arrangement on a regular basis.

Other IASB Pronouncements

32. The following table summarises other IASB pronouncements that have not yet been included in the PBE Standards which we are continuing to monitor.

NZASB Approval and Date	**IASB Pronouncement**	**Status**
Approval 89 – August 2017	IFRIC 23 *Uncertainty over Income Tax Treatments*	In August 2017, the Board considered the application of the PBE Policy Approach to NZ IFRIC 23, and agreed to propose the incorporation of NZ IFRIC 23 into PBE IAS 12 *Income Taxes*. Although the initial plan was to include this proposal in the *2018 Omnibus Amendments to PBE Standards*, it was inadvertently omitted. Therefore, we are seeking approval at this meeting (see agenda item 9) to issue an ED and ITC proposing to incorporate NZ IFRIC 23 into PBE IAS 12 by adding an appendix to PBE IAS 12.
Approval 103 – December 2018	*Definition of a Business* (Amendments to IFRS 3)	In December 2018, the Board considered the application of the PBE Policy Approach to *Definition of a Business* (Amendments to IFRS 3) and noted that the IPSASB plans to include this project in its workplan for 2019–2023. Staff understand that the IPSASB is likely to consider these amendments in 2019 or 2020. The Board agreed to wait for the IPSASB to consider the amendments to IFRS 3 before deciding whether to incorporate them in the PBE Standards.
Approval 104 – December 2018	*Definition of Material* (Amendments to IAS 1 and IAS 8)	At its December 2018 meeting, the Board also considered the application of the PBE Policy Approach to the *Definition of Material* (Amendments to IAS 1 and IAS 8) and the *Definition of Material* (Amendments to Conceptual Frameworks). The Board noted that both projects are on the IPSASB's proposed work plan for 2019-2023. The Board agreed to wait for the IPSASB to consider these amendments before deciding whether to incorporate them into PBE Standards.
Approval 105 – December 2018	*Definition of Material* (Amendments to Conceptual Frameworks)	

B. IPSASB Pronouncements

Financial Instruments

33. In the table below we have summarised the IPSASB pronouncements that relate to financial instruments that have not been incorporated into PBE Standards.

Date	**IPSASB Pronouncement**
August 2018	IPSAS 41 *Financial Instruments*
January 2019	*Long-term Interests in Associates and Joint Ventures (Amendments to IPSAS 36) and Prepayment Features with Negative Compensation (Amendments to IPSAS 41)*

34. In August 2018, the IPSASB issued IPSAS 41 *Financial Instruments* with an effective date of 1 January 2022. IPSAS 41 is closely based on IFRS 9 (2014) *Financial Instruments.* In September 2018 the Board confirmed its intention to develop a PBE Standard based on IPSAS 41.

35. In November 2018, the Board issued for comment[7] two exposure drafts. The first exposure draft, ED PBE IPSAS 41 *Financial Instruments* contained proposals to update the requirements for the recognition and measurement of financial instruments for Tier 1 and Tier 2 PBEs. The proposals align the requirements in PBE Standards with IPSAS 41 (and NZ IFRS 9 *Financial Instruments).*

36. When finalised, PBE IPSAS 41 will supersede most of PBE IPSAS 29 *Financial Instruments: Recognition and Measurement* (apart from the hedging requirements). It will also supersede PBE IFRS 9 *Financial Instruments.* ED PBE IPSAS 41 contains the hedge accounting requirements in IFRS 9. ED PBE IPSAS 41 includes *Long-term Interests in Associates and Joint Ventures* (Amendments to IPSAS 36) and *Prepayment Features with Negative Compensation* (Amendments to IPSAS 41).

37. A second exposure draft, NZASB ED 2018-6 *Effective Date of PBE IFRS 9* was also issued. This ED proposed to defer the effective date of PBE IFRS 9 by a year to 1 January 2022 (to prevent it from becoming mandatorily effective before the effective date of PBE IPSAS 41).

38. PBE IPSAS 41 contains separate transition provisions for entities that have early adopted PBE IFRS 9. These provisions aim to keep the transition process as simple as possible.

39. The Board will consider submissions received on the EDs at this meeting (see agenda item 6).

Recommendation We recommend that the Board NOTES that PBE IPSAS 41 *Financial Instruments* is in the process of finalisation for issue.

[7] The comment deadline was 28 February 2019.

Public Sector Combinations

40. In the table below we have summarised the IPSASB pronouncement that relate to public sector combinations that have not been incorporated into PBE Standards.

Date	IPSASB Pronouncement
January 2017	IPSAS 40 *Public Sector Combinations*

41. At its meeting in February 2017, the Board considered the application of the PBE Policy Approach to IPSAS 40. The Board agreed to develop an ED based on IPSAS 40.

42. ED *PBE Combinations* (the ED) was issued for comment in September 2018. The ED is based on IPSAS 40 and sets out proposals for accounting for amalgamations and acquisitions that would replace the current requirements of PBE IFRS 3 *Business Combinations.*

43. There are some significant differences between the proposals in the ED and the requirements in PBE IFRS 3. The ED has a broader scope than PBE IFRS 3[8] and proposes to establish requirements for both amalgamations and acquisitions.

44. The Board will consider submissions received on the ED at this meeting (see agenda item 4).

> ***Recommendation***
> We recommend that the Board NOTES that PBE IPSAS 40 *PBE Combinations* is in the process of finalisation for issue.

Social Benefits

45. At its February 2019 meeting, the Board noted that the IPSASB has issued IPSAS 42 *Social Benefits*.

46. Staff recommended that the most efficient approach would be to seek feedback from PBEs on all proposals for non-exchange expenses at the same time and then finalise all the relevant requirements together.

47. The Board agreed with the staff recommendation that it should defer its decision to develop a PBE Standard based on IPSAS 42 until the IPSASB has completed other related projects dealing with non-exchange expenses.

> ***Recommendation***
> We recommend that the Board NOTES that it has AGREED to DEFER its decision to develop a PBE Standard based on IPSAS 42 *Social Benefits* until the IPSASB has completed other related projects dealing with non-exchange expenses.

[8] The scope of PBE IFRS 3 excludes combinations under common control and combinations arising from local authority reorganisations.

Other IPSASB Pronouncement

48. The IPSASB issued *Improvements to IPSAS, 2018* in October 2018. We sought feedback on the proposals concurrently with the IPSASB and in nearly all cases we proposed to incorporate equivalent amendments in the PBE Standards. The only IPSASB proposals not incorporated in the *2018 Omnibus Amendments to PBE Standards* were in relation to certain amendments to IPSAS 16 *Investment Property.* The IPSASB made these amendments after the exposure draft comment period had ended.

49. At its 31 October 2018 meeting the Board agreed to consider the IPSASB's amendments to IPSAS 16 in a future omnibus ED.

50. Staff have subsequently contacted IASB staff to see if the IASB plans to incorporate these amendments into IAS 40 *Investment Property.* IASB staff have indicated that at this stage they do not propose to include these amendments in IAS 40.

Related links

PBE Policy Approach (December 2018)

NZ ACCOUNTING STANDARDS BOARD

Memorandum

Date:	8 March 2019
To:	NZASB Members
From:	Aimy Luu Huynh
Subject:	**IPSASB ED 67 Collective and Individual Services and Emergency Relief (Amendments to IPSAS 19)**

Recommendations

1. We recommend that the Board:

   (a) CONSIDERS IPSASB ED 67 *Collective and Individual Services and Emergency Relief* (Amendments to IPSAS 19) (the ED); and

   (b) PROVIDES feedback on the Specific Matters for Comment in the ED for the purpose of providing DIRECTION for staff to draft the NZASB's comment letter (agenda item 8.2).

Structure of the memo

2. The memo is structured as follows:

   (a) Background;

   (b) Different scope exclusion in PBE IPSAS 19;

   (c) Guidance from Treasury;

   (d) Draft comment letter; and

   (e) Next steps.

Background

3. When IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* was first issued, "provisions and contingent liabilities arising from social benefits provided by an entity for which it does not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of those benefits" were excluded from the scope of the Standard.

4. The IPSASB issued IPSAS 42 *Social Benefits* in January 2019. IPSAS 42 amended IPSAS 19 by deleting the scope exclusion above and replacing it with "social benefits within the scope of IPSAS 42" (i.e., cash transfers (including cash equivalents) provided to mitigate the effect of social risks, rather than the wider range of transactions previously referred to as social benefits).

5. A consequence of this amendment was to bring within the scope of IPSAS 19 any provisions and contingent liabilities arising from transactions that were previously excluded from the scope of IPSAS 19, but which are not within the scope of IPSAS 42. The IPSASB therefore agreed to provide requirements and guidance on accounting for these transactions and events. As was previously noted in IPSAS 19, a key issue for stakeholders was whether a provision arose in respect of those transactions.

6. The IPSASB published the ED containing the proposed amendments to IPSAS 19 in February. The ED forms part of the IPSASB's broader non-exchange expenses project. The ED addresses transactions and events for collective services and individual services and emergency relief. Grants, contributions and other transfers are being addressed in a separate exposure draft.

7. Comments on the ED are due to the NZASB by 5 April 2019 and to the IPSASB by 31 May 2019.

8. To assist the Board in developing its response to the ED we sought informal feedback from some public sector entities and not-for-profit entities that provide collective services, individual services and emergency relief (collectively referred to as targeted outreach). We also hosted a meeting with representatives from Treasury and Audit NZ (collectively referred to as the discussion group).

9. We have also received feedback on the ED from a Board member.

10. There is a close link between IPSAS 42 and the ED. We have made references to IPSAS 42 in the draft comment letter, therefore we have included IPSAS 42 in the supporting papers at agenda item 8.5.

Different scope exclusion in PBE IPSAS 19

11. When the Board developed PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* it did not use the social benefits scope exclusion paragraphs in IPSAS 19. Instead the Broad carried forward the scope exclusion paragraphs for the Crown from NZ IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* (PBE version).

12. PBE IPSAS 19 scopes out obligations of the Crown expressed in legislation that have characteristics similar to an executory contract such as future social welfare payments, the delivery of future education and health services.

13. Despite this scope exclusion, PBEs would have applied PBE IPSAS 19 to a range of other transactions and events. This scope exclusion was intended to be a short-term measure pending the completion of various IPSASB projects, including social benefits.

Guidance from Treasury

14. In 2013 the Treasury, with the assistance of the OAG, issued *Guidance on Recognising Liabilities and Expenses* (the Treasury Guidance). This is a very useful document and we have referred to this in the draft comment letter. A copy of the Treasury Guidance is included in the supporting papers at agenda item 8.8.

15. The purpose of the Treasury Guidance is to provide interim application guidance to operationalise current standards so that practice is both compliant with GAAP and that consistent treatment is followed.[1]

16. The Treasury Guidance summaries GAAP (mainly from NZ IAS 37 (PBE) and PBE IPSAS 19), provides application guidance with a focus on non-exchange transactions and provides examples illustrating when it is appropriate to recognise provisions and constructive obligations.[2]

17. The Treasury Guidance includes an illustrative example on the delivery of relief in response to a specific emergency (Christchurch Earthquake – offer to red zone property owners). The Treasury Guidance includes a list of criteria to be used for determining when a present obligation arises pursuant to a (non-legislated) policy of the Government. While we note that applying the proposals in the ED and the Treasury Guidance would both result in the recognition of a provision (i.e. the same accounting outcome), we found the Treasury Guidance to be more helpful in working through the principles in IPSAS 19. We received the same feedback from the discussion group, and this has been noted in the draft comment letter.

Draft comment letter

18. A draft comment letter is provided as agenda item 8.2. The draft comment letter includes:
    (a) informal feedback from targeted outreach;
    (b) feedback from the discussion group;
    (c) feedback from a Board member;
    (d) staff notes;
    (e) the Board's comments from ED 63 *Social Benefits* and Consultation Paper *Accounting for Revenue and Non-Exchange Expenses* where they are relevant; and
    (f) staff's preliminary response.

19. The draft comment letter is currently in a bullet point format. All the points are intended to prompt discussion and assist the Board in developing a response for the specific matters for comment.

Next steps

20. At the next Board meeting (2 May 2019), we will provide an updated draft comment letter and an analysis of any submissions received.

21. Comments are due to the IPSASB before the June Board meeting, so the next meeting is the final chance for the full Board to provide feedback. The steps to finalise the comment letter can be discussed at the May meeting.

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1 The Treasury Guidance, paragraph 3.
2 ibid.

Attachments

Agenda item 8.2:	NZASB draft comment letter on ED 67
Agenda item 8.3:	ED 67
Agenda item 8.4:	At a Glance ED 67 (in supporting papers)
Agenda item 8.5:	IPSAS 42 *Social Benefits* (in supporting papers)
Agenda item 8.6:	NZASB's comment letter on ED 63 *Social Benefits* (in supporting papers)
Agenda item 8.7:	NZASB's comment letter on Consultation Paper *Accounting for Revenue and Non-Exchange Expenses* (in supporting papers)
Agenda item 8.8:	Treasury's *Guidance on Recognising Liabilities and Expenses* (in supporting papers)

NZ ACCOUNTING
STANDARDS
BOARD

XX May 2019

Mr John Stanford
Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto
Ontario M5V 3H2
CANADA
Submitted to: www.ifac.org

Dear John

Exposure Draft 67 *Collective and Individual Services and Emergency Relief* (Amendments to IPSAS 19)

Thank you for the opportunity to comment on Exposure Draft 67 *Collective and Individual Services and Emergency Relief* (Amendments to IPSAS 19) (the ED). The ED was exposed for comment in New Zealand and some New Zealand constituents may have commented directly to you.

[The main points will be noted in the cover letter when the comments are finalised]

Our responses to the Specific Matters for Comment in the ED are set out in the Appendix to this letter. If you have any questions or require clarification of any matters in this submission, please contact Aimy Luu Huynh (aimy.luuhuynh@xrb.govt.nz) or me.

Yours sincerely

Kimberley Crook
Chair – New Zealand Accounting Standards Board

APPENDIX Response to Specific Matters for Comment

General comments

Feedback from the discussion group

- Agree with the accounting outcome in the ED, but the ED has not drawn out the conceptual distinction between present and future obligations and the principles in IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*. There is a risk that the ED will be considered rules based.
- The lack of proper guidance for collective services, individual services and emergency relief (in particular) could make it challenging for the grants, contributions and other transfers project because there could be overlap in the two projects.
- A lot of judgement is required in interpreting IPSAS 19 especially when applying to emergency relief, it would be helpful if more guidance was in the ED.
- The ED is unlikely to change current accounting practice for collective services and individual services. For emergency relief there would be a lot of judgement in assessing whether ongoing emergency relief is analogous to collective and individual services or whether it is in response to a specific emergency.
- Emergency relief is not an economic phenomenon that should have its own category and it should not be treated any differently from similar non-exchange expenses.

Specific Matter for Comment 1

Do you agree with the definitions of collective services and individual services that are included in this Exposure Draft?

If not, what changes would you make to the definitions?

Notes for SMC 1

Feedback from the discussion group

- No definition provided for emergency relief? Why?
- There are no specific issues with the definitions. It would be difficult to have one definition that covers both collective services and individual services.
- The distinction between collective services and individual services seems reasonable and the distinction is helpful to understand the activities of governments.

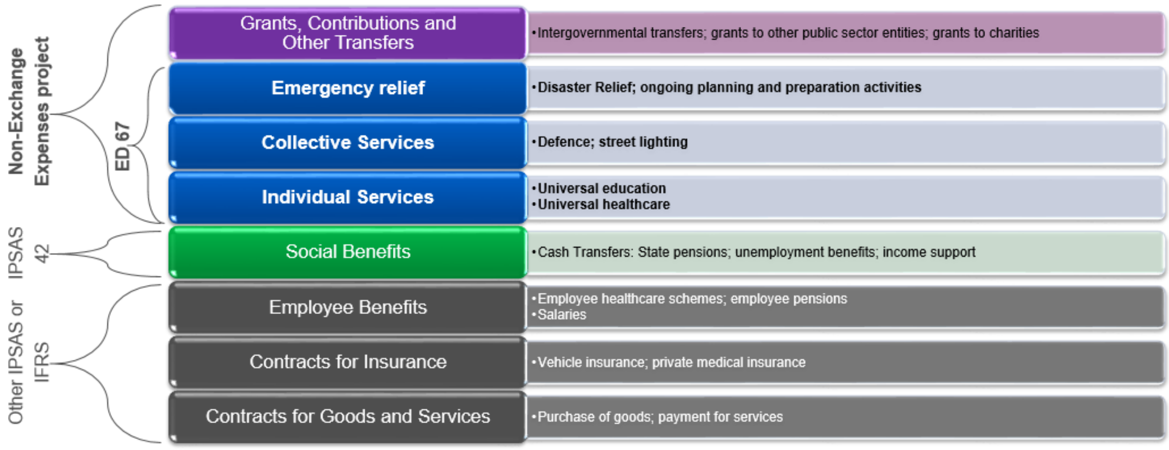
Feedback from a Board member

- The accounting treatment for collective services and individual services is the same. Is it necessary to have a boundary between collective services and individual services? This could create confusion when there is no impact on the accounting.

Staff notes

- Staff acknowledge that the ED forms part of the IPSASB's broader non-exchange expenses project. The IPSASB has categorised non-exchange expenses into social benefits, grants, contributions and other transfers, collective services, individual services and emergency relief.

The IPSASB is working on developing accounting requirements for each category in turn, which is most likely its rationale in distinguishing between collective services and individual services. This can be seen in the diagram below.



Staff's preliminary response

- Apart from our suggestions below, we agree with the definitions of collective services and individual services that are included in the ED.
- In paragraph BC11 (see below) of the ED the IPSASB noted that the reasons for not recognising a provision for collective services and individual services are not identical but the guidance provided in the ED is essentially identical. We would suggest that the IPSASB provide further discussion of the differences between collective services and individual services. This would assist the readers to appreciate the IPSASB's rationale for distinguishing between collective services and individual services in the ED.

  BC11. In agreeing that liabilities or expenses for the delivery of these services do not arise prior to the delivery of the services to beneficiaries, the IPSASB noted that the reasons a provision did not arise for collective services and universally accessible services were not identical. The IPSASB agreed that the guidance should reflect this.

- It would be helpful to include in the respective definitions the examples of collective services and individual services provided in paragraph AG5 of the ED, "Examples of collective services include street lighting and defence. Examples of individual services include public sector healthcare services and education services". The IPSASB has used examples in the past to provide further clarity to definitions, for example most recently in the definition of social risk in IPSAS 42 *Social Benefits*.

Specific Matter for Comment 2
Do you agree that no provision should be recognised for collective services?
If not, under what circumstances do you think a provision would arise?

Specific Matter for Comment 3
Do you agree that no provision should be recognised for individual services?
If not, under what circumstances do you think a provision would arise?

NB: SMC 2 and SMC 3 are considered together because the nature of the expense is very similar.

Notes for SMC 2 and SMC 3

Feedback from targeted outreach

- A ministry that provides a significant individual service notes that its current practice is to recognise the expense as the services are provided and no provision is recognised for this service. The ED would not change current practice and they don't have any concerns with the proposals.
- Based on a public sector entity's interpretation of the ED they thought the ED requires collective services and individual services to be presented separately in the financial statements. They noted that it would be challenging if it had to present separately collective services expense and individual services expense because it provides a wide range of services. Going through all the services and making this classification would require a change in system and would be costly and time consuming.

Feedback from the discussion group

- The ED is unlikely to change current accounting practice for collective services and individual services. The main challenges in practice relate to accounting for specific events such as a natural disaster or a government announcement and also the accounting for grants expenditure.
- The ED has not drawn out the conceptual distinction between present and future obligations and not provided enough guidance on the principles in IPSAS 19 and this creates a risk that the ED will be considered rules based. Paragraph AG 10 of the ED attempts to draw this distinction, but the discussion is very brief. The Treasury's *Guidance on Recognising Liabilities and Expenses* (the Treasury Guidance), paragraph 9 (shown below) makes more effort in drawing out the distinction between present and future obligations and the principles of PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*.

> 9. It is only those obligations arising from past events existing independently of an entity's future actions (i.e. the future conduct of its business) that are recognised as provisions. Because of commercial pressures or legal requirements, an entity may intend or need to carry out expenditure to operate in a particular way in the future (for example, by fitting smoke filters in a certain type of factory). Because the entity can avoid the future expenditure by its future actions, for example by changing its method of operation, it has no present obligation for that future expenditure and no provision is recognised.

- The reference to obligations such as in paragraph AG10 of the ED should be made clear that it is obligations to the community at large because there are different forms of obligations and to different parties.
- The Treasury Guidance provides guidance on a number of principles from PBE IPSAS 19 and these are either not covered or insufficient guidance is included in the ED, these include the following.
    - Is the obligation ongoing and adjustable?
    - Does the obligation arise pursuant to legislation or deed of settlement?

- Does the obligation arise pursuant to a government policy?

Comments from a Board member

- A Board member agrees with the outcome in the ED (i.e. no provision for collective services and individual services) but not with the rationale provided in the ED.
- The rationale provided in the ED is based solely on an interpretation of one specific part (paragraph 26) of IPSAS 19, rather than focusing on similar issues that were considered in the development of IPSAS 42. This approach appears to be based on decisions made about the scope of IPSAS 42. The narrowing of the scope of IPSAS 42, compared with ED 63 *Social Benefits*, does not change the conceptual issues that need to be considered.
- In the Board's comment letter on ED 63, the key question of when, in concept, a liability to beneficiaries arises in relation to collective services and individual services is essentially the same as for social benefits within the scope of IPSAS 42. "In our view, there is no substantive difference between obligations for benefits to be provided in the form of money (for example, national superannuation) or in the form of services (for examples, education services)".
- Therefore, the Board member disagrees with the conclusion in BC29 of IPSAS 42 that the economic substance of cash transfers made to individuals and households is different from the services provided to individuals and households. When considering the definition of a liability in the Conceptual Framework, the key question is determining the point in time when an obligation to beneficiaries arises. Whilst the entity has to enter into exchange transactions with other parties to deliver the necessary services to beneficiaries this is not determinative of when an obligation to beneficiaries arises. So whilst the Board member agrees that there is no liability to the suppliers of those services (including employees) until such time as those suppliers have provided those services, consistent with the treatment of other exchange transactions under IPSAS, that conclusion does not assist with determining when an obligation to beneficiaries arises. The rationale in BC28 and BC29 of IPSAS 42 has drawn a distinction based on the form of settlement (cash transfers vs services) and appears to confuse the differences in how an obligation to beneficiaries might be settled with the more fundamental question of when such an obligation to beneficiaries arises.
- The Board's comment letter on ED 63 acknowledges that determining the relevant past event for all forms of social benefits (whether provided in the form of cash or services) is difficult and has been the subject of much debate over the years. However, having reached a conclusion in IPSAS 42, the Board member is of the view that the basis for conclusion (BC) should have at least documented the IPSASB's consideration and deliberations on how that conclusion might apply to individual and collective services. For example, if a beneficiary of a particular health service (e.g. a hip replacement operation) has met all of the eligibility criteria to receive that service before balance date, with the services scheduled to be provided after balance date, should a liability to the beneficiary be recognised at balance date?
- The Board member's reason for disagreeing with the rationale in the ED is consistent with the Board's comment letter on ED 63 – even if it is possible to argue that an obligation to provide services to beneficiaries arises in advance of when those services are delivered, the recognition of liabilities for services to be delivered in the future, without the recognition of

future taxes to pay for those services, is unlikely to meet the objective of financial reporting and satisfy the qualitative characteristics.

Staff's preliminary response

- We agree that no provision should be recognised for collective services and individual services.
- We do not agree with the rationale provided in the ED.
- The rationale provided in the ED is based solely on an interpretation of one specific part (paragraph 26) of IPSAS 19, rather than commencing with a discussion of similar issues that were considered in the development of IPSAS 42.
- The ED has not drawn out the conceptual distinction between present and future obligations and not provided enough guidance on the principles of IPSAS 19 and this creates a risk that the ED is considered to be rules based.
- The key question of when, in concept, a liability to beneficiaries arises in relation to collective and individual services is essentially the same as for social benefits within the scope of IPSAS 42. In the Board's comment letter on ED 63 we have said, "In our view, there is no substantive difference between obligations for benefits to be provided in the form of money (for example, national superannuation) or in the form of services (for examples, education services)".
- When considering the definition of a liability in the Conceptual Framework, the key question is determining the point in time when an obligation to beneficiaries arises. Whilst the entity has to enter into exchange transactions with other parties to deliver the necessary services to beneficiaries this is not determinative of when an obligation to beneficiaries arises. The rationale in BC28 and BC29 of IPSAS 42 has drawn a distinction based on the form of settlement (cash transfers vs services), and appears to confuse the differences in <u>how</u> an obligation to beneficiaries might be settled with the more fundamental question of <u>when</u> such an obligation to beneficiaries arises.
- We would have expected to see in the BC the IPSASB's consideration and deliberations on how the conclusion in IPSAS 42 about the past event might apply to individual services and collective services. For example, if a beneficiary of a particular health service (e.g. a hip replacement operation) has met all of the eligibility criteria to receive that service before balance date, with the services scheduled to be provided after balance date, should a liability to the beneficiary be recognised at balance date?
- Our reason for disagreeing with the rationale in the ED is consistent with the Board's comment letter on ED 63 – the recognition of liabilities for services to be delivered in the future, without the recognition of future taxes to pay for those services, is unlikely to meet the objective of financial reporting and satisfy the qualitative characteristics.
- In the Board's comment letter on the Consultation Paper *Accounting for Revenue and Non-Exchange Expenses*, it noted that there are various stages of implementing a programme of delivering services to the public. AG11 of the ED notes that in delivering collective services an entity incurs expenses and acquires resources through exchange transactions and these are

accounted for in accordance with other IPSAS. It is not clear in the ED when the present obligation for the delivery of the collective services arises and to whom the present obligation arises. It would be helpful if the ED provides more guidance on this.

Specific Matter for Comment 4
Do you agree with the proposed accounting for emergency relief?
If not, how do you think emergency relief should be accounted for?

Notes for SMC 4

<u>Comments from targeted outreach</u>

- A public sector entity that provides emergency relief notes that the proposals would not change its current practice. Emergency relief for specific emergencies are recognised as a provision or contingent liability when the requirements in PBE IPSAS 19 are satisfied. Emergency relief provided as part of the ongoing activities of the entity are recognised as the services are provided.
- A not-for-profit entity that provides emergency relief has the following comments about the ED.
  - The proposals would not change its current practice. Expenses that relate to emergency relief are recognised as they are incurred. No provision is recognised because often the entity does not know the amount of the expenditure.
  - The proposals would make them reconsider whether the emergency relief would meet the recognition criteria for a provision or a contingent liability.
  - The proposals seem to be clear and would not see any issues with implementing the requirements and guidance.

<u>Comments from the discussion group</u>

- The ED does not provide a strong rationale why emergency relief is different from social benefits, collective services and individual services. Emergency relief could be an example of one or more of these categories as well as being a provision. Rather than having a separate category for emergency relief, the IPSASB could have dealt with this event through the provision of illustrative examples in the ED.
- The discussion group is of the view that that emergency relief <u>does</u> address the needs to society as a whole.
- Paragraph AG7 of the ED, it is not clear what “Conversely” means.
- There could be emergency relief which meets the definition of a social benefit, but the ED has not discussed the option of accounting for such event as a social benefit under IPSAS 42. For example, after the Christchurch earthquake, some beneficiaries received additional payments to assist them during the post recovery of the earthquake. This is a *social benefit* in response to an emergency event. It does not seem necessary to assess whether this is an emergency relief as an ongoing activity or in response to a specific emergency as proposed by the ED.

- Some entities could have both types of emergency relief and it could be challenging to distinguish whether it is an ongoing activity or in response to a specific emergency under the ED.

  For example, under the Civil Defence Emergency Management Act 2002, the Ministry of Civil Defence and Emergency Management operates a national civil defence emergency management plan (the Plan) where it reimburses some of local council's emergency response and recovery costs for natural disasters, such as earthquakes and flooding events. This includes reimbursing some or all of the cost of replacing and repairing infrastructure assets damaged by natural disasters. There is a permanent budget authority for the Plan, meaning obligations under the Plan are funded for in an Act of Parliament and will therefore remain in place permanently until repealed from the legislation.

  The current accounting for the Plan is as follows.

  - The obligating event is the occurrence of the natural disaster event that causes damage and destruction. Therefore, a provision is recognised when a reliable estimate can be made of the payments the Government expects to make as a result of the event.
  - A contingent liability with no quantifiable amount is disclosed for events that have occurred, but claims have not been received.

- Emergency relief as an ongoing activity is analogous to defence services, it is stand ready[1] to provide the services but it does not mean there is a present obligation because the past event has not occurred yet i.e. the natural disaster. When the emergency event arises, there could be a mixture of services which are made up of different types of non-exchange expenses. Hence emergency relief is not an economic phenomenon that should have its own category and should not be treated any differently from similar non-exchange expenses.
- Based on the feedback above, the discussion group disagrees with paragraph AG18 of the ED and recommends that it is deleted. The paragraph may seem to be helpful, but it is providing specific situations which could be seen to be rules based.
- The lack of proper guidance in the ED could make it challenging for the grants, contributions and other transfers project because there could be overlap in the two projects.
- There are a lot of challenges and judgement required in applying PBE IPSAS 19 to emergency relief, this was one of the reasons for developing the Treasury Guidance. The ED does not address these challenges and judgement and there is a risk that it is rules based.
- The preference is to have one standard on all non-exchange expenses. The standard would have clear principles and separate sections dealing with the different types of non-exchange expenses. The structure could be like IPSAS 41 *Financial Instruments*.

[1] BC5.23–BC5.25 of the Conceptual Framework discuss stand-ready obligations. Stand-ready obligations require an entity to be prepared to fulfil an obligation if a specified future event outside the entity's controls occurs (or fails to occur). The IPSASB is of the view that that such obligations should be considered at the standards level consistent with the principles established in the Conceptual Framework. The IPSASB decided that the Conceptual Framework should not resolve whether all obligations that might be classified as stand-ready meet the definition of a liability. The IPSASB also decided that the term stand-ready obligation should not be used in the Conceptual Framework.

Comments from a Board member

- A Board member agrees there is no provision for emergency relief which are the on-going activities of government but disagrees with the rationale provided in the ED.
- A Board member thought social benefits, individual services and collective services and emergency relief provided as an ongoing activity are all funded from future taxes: as noted in PBE IPSAS 19, these transactions have characteristics similar to executory contracts in that the community will, collectively, provide funds to the government in the future under tax legislation, and the government will, in return, provide goods, services or transfers to the community in the future – essentially, there are rights (to future taxes) and obligations (to provide cash, goods and services to beneficiaries) already established under legislation, and there is an interdependency between those rights and obligations. In these circumstances, even if you argue that the rights and obligations are separable (e.g. as they involve different individual parties), unlike a typical executory contract for an exchange transaction (which is one reason why the executory contract analogy is not perfect), the overall collective interdependency between these rights and obligations is the key reason why it doesn't provide useful information to recognise large liabilities for obligations to beneficiaries under these types of government programmes that are funded by future taxes.
- The executory contract analogy does not apply to emergency relief provided to specific emergencies because the relief is ad hoc, in additional to and distinct from the on-going activities of the government and it is at the discretion of the government. This type of emergency relief has similar characteristics to grants.

Staff notes

- The Board member's comments about these transactions and events being similar to executory contracts are consistent with our current scope exclusion paragraphs in PBE IPSAS 19, an extract is provided below.

The Crown

11.1 Obligations of the Crown expressed in legislation that have characteristics similar to an executory contract are those where:

(a) The Crown is obligated to provide goods, services or transfers to the community in future periods using funding to be obtained from the community substantially in those future periods; and

(b) The intended third party recipients of the goods, services or transfers have not yet satisfied the criteria for entitlement to those goods, services or transfers.

11.2 These obligations of the Crown have characteristics similar to executory contracts in that the community will, collectively, provide funds to the Crown in the future under tax legislation, and the Crown will, in return, provide goods, services or transfers to the community in the future. Such obligations of the Crown include obligations to make future social welfare payments (such as to pay unemployment, domestic purposes and national superannuation benefits) and to deliver future health and education services, to the extent that the substantial funding of those benefits will be met through future taxation and other revenues and the intended recipients have not already satisfied the criteria for entitlement to those benefits. However, such obligations exclude the obligation of the Crown to fund future payments by the Government Superannuation Fund since the recipients of those future payments have already performed services giving rise to obligations.

11.3 The exclusion from the application of this Standard of obligations of the Crown that have characteristics similar to an executory contract is not intended to achieve a different result, in terms of the Crown's recognition of liabilities, from the practice followed at the date of introduction of this Standard to recognise liabilities only where the recipients of benefits to be provided in the future have already satisfied the criteria for entitlement to those benefits.

Staff's preliminary response

- We agree with the proposed accounting for emergency relief, but we disagree that emergency relief is a separate category of non-exchange expenses. Our reasons are provided below.
- Emergency relief is not an economic phenomenon that should have its own category and it should not be treated any differently from similar non-exchange expenses. Our reasons are as follows.
  - Paragraph AG18 of the ED states "Goods and services delivered through emergency relief do not address the needs of society as a whole. This distinguishes emergency relief from collective services and individual services". We disagree with this statement, providing aid and funding after a natural disaster helps the individuals and households to resume with their daily activities, this is addressing the needs of society as a whole. This statement also calls into question the conclusions reached previously by the IPSASB on individual services and cash transfers to individual households (social benefits).
  - In the Board's comment letter on ED 63 it disagreed with the argument that social risks and other risks (for example, earthquakes and flooding) are different. Governments do react to specific disasters, but they may also have standing benefits available for natural disasters. For example, New Zealand farmers affected by an adverse event (for example, flood or drought) which is classed as medium or large-scale by the Minister for Primary Industries, may qualify for a Rural Assistance Payment. Although the severity of the adverse event has to be assessed, the benefit is a standing benefit to deal with the social risks resulting from the adverse event.
  - Emergency relief as an ongoing activity is analogous to defence services, it is stand ready to provide the services, but it does not mean there is a present obligation because the past event has not occurred yet i.e. the natural disaster. When the emergency event arises, there could be a mixture of services which are made up of different types of non-exchange expenses.
  - Social benefits, individual and collective services and emergency relief provided as an ongoing activity are all funded from future taxes: as noted in PBE IPSAS 19, these transactions have characteristics similar to executory contracts in that the community will, collectively, provide funds to the government in the future under tax legislation, and the government will, in return, provide goods, services or transfers to the community in the future. These are not a typical executory contract for an exchange transaction (the executory contract analogy is not perfect), the overall collective interdependency between these rights and obligations is the key reason why it doesn't provide useful information to recognise large liabilities for obligations to beneficiaries under these types of government programmes that are funded by future taxes.

- Some entities could have both types of emergency relief and it could be challenging to distinguish whether it is an ongoing activity or in response to a specific emergency under the ED. An example is the national civil defence emergency management plan (the Plan) set under the Civil Defence Emergency Management Act 2002. The Plan is an ongoing activity of a public sector entity, but emergency relief is only provided after an emergency event. The current practice is to apply PBE IPSAS 19 and a provision is recognised.
- The executory contract analogy does not apply to emergency relief provided to specific emergencies because the relief is ad hoc, in additional to and distinct from the on-going activities of the government and it is at the discretion of the government. This type of emergency relief has similar characteristics to grants.
- The IPSASB needs to be cognisant of the current project on grants, contributions and other transfers. Where emergency relief has similar characteristics to grants, we would expect a consistent and coherent approach to the accounting of such transactions.
- The current drafting of the ED seems quite rules based, for example paragraph AG18 provides quite specific situations but in reality, governments do much more. A rules-based standard would make it challenging for entities with very specific situations to apply. The ED should provide more guidance to assist entities to work through the challenges and judgements in applying the principles of IPSAS 19, in particular additional guidance would be required if the IPSASB intends to keep a separate category for emergency relief and the two types of emergency relief.

Other comments

Staff's preliminary response

- We suggest clarifying BC20 of the ED. The BC seems to suggest that the IPSASB concluded that the requirements in IPSAS 19 are sufficient for emergency relief that is not an ongoing activity of government and agreed not to develop further requirements. However, the ED has proposed further requirements for emergency relief in response to specific emergencies so there seems to be a contradiction here.

Exposure Draft 67
January 2019
Comments due: May 31, 2019

IPSAS®

Proposed International Public Sector Accounting Standard®

Collective and Individual Services and Emergency Relief (Amendments to IPSAS 19)

IPSASB International Public Sector Accounting Standards Board®

This document was developed and approved by the International Public Sector Accounting Standards Board® (IPSASB®).

The objective of the IPSASB is to serve the public interest by setting high-quality public sector accounting standards and by facilitating the adoption and implementation of these, thereby enhancing the quality and consistency of practice throughout the world and strengthening the transparency and accountability of public sector finances.

In meeting this objective the IPSASB sets IPSAS® and Recommended Practice Guidelines (RPGs) for use by public sector entities, including national, regional, and local governments, and related governmental agencies.

IPSAS relate to the general purpose financial statements (financial statements) and are authoritative. RPGs are pronouncements that provide guidance on good practice in preparing general purpose financial reports (GPFRs) that are not financial statements. Unlike IPSAS RPGs do not establish requirements. Currently all pronouncements relating to GPFRs that are not financial statements are RPGs. RPGs do not provide guidance on the level of assurance (if any) to which information should be subjected.

The structures and processes that support the operations of the IPSASB are facilitated by the International Federation of Accountants® (IFAC®).

REQUEST FOR COMMENTS

This Exposure Draft, *Collective and Individual Services and Emergency Relief* (Amendments to IPSAS 19), was developed and approved by the International Public Sector Accounting Standards Board® (IPSASB®).

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by May 31, 2019.**

Respondents are asked to submit their comments electronically through the IPSASB website, using the "Submit a Comment" link. Please submit comments in both a PDF and Word file. Also, please note that first-time users of the website must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website. This publication may be downloaded from the IPSASB website: www.ipsasb.org. The approved text is published in the English language.

This Exposure Draft forms part of the IPSASB's project on Non-Exchange Expenses.

Objective of the Exposure Draft

The objective of this Exposure Draft is to propose improvements to the relevance, faithful representativeness and comparability of the information that a reporting entity provides in its financial statements about collective services, individual services and emergency relief.

Guide for Respondents

The IPSASB would welcome comments on all of the matters discussed in this Exposure Draft. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

The Specific Matters for Comment requested for the Exposure Draft are provided below.

Specific Matter for Comment 1:

Do you agree with the definitions of collective services and individual services that are included in this Exposure Draft?

If not, what changes would you make to the definitions?

Specific Matter for Comment 2:

Do you agree that no provision should be recognized for collective services?

If not, under what circumstances do you think a provision would arise?

Specific Matter for Comment 3:

Do you agree that no provision should be recognized for individual services?

If not, under what circumstances do you think a provision would arise?

Specific Matter for Comment 4:

Do you agree with the proposed accounting for emergency relief?

If not, how do you think emergency relief should be accounted for?

COLLECTIVE AND INDIVIDUAL SERVICES AND EMERGENCY RELIEF (AMENDMENTS TO IPSAS 19)

CONTENTS

Objective

1. The objective of this Exposure Draft (ED) is to propose amendments to IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, to provide guidance on accounting for collective and individual services and emergency relief. These transactions may have been previously encompassed in the wide description of social benefits in the IPSAS 19 scope exclusion. Following the publication of IPSAS 42, *Social Benefits*, the IPSASB has adopted a narrower definition of social benefits that excludes collective and individual services and emergency relief. Subsequently, the IPSASB decided to provide guidance for these transactions through the amendments proposed in this ED.

2. This ED forms part of the IPSASB's project to provide guidance on accounting for non-exchange expenses.

Request for Comments

3. The IPSASB would welcome comments on all the matters proposed in the ED. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

IPSAS Addressed

IPSAS	***Summary of Proposed Change***
IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*	Provide guidance on accounting for collective and individual services and emergency relief.
IPSAS 42, *Social Benefits*	Consequential amendment to provide a cross reference to the additional guidance included in IPSAS 19 for certain transactions outside the scope of IPSAS 42.

Amendments to IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*

Paragraphs 6A and 111J are added and paragraph 18 is amended. New text is underlined.

…

Scope

6A. This Standard provides guidance on accounting for non-exchange transactions arising from:

(a) Collective and individual services (paragraphs AG2–AG16); and

(b) Emergency relief (paragraphs AG17–AG25).

…

Definitions

18. **The following terms are used in this Standard with the meanings specified:**

Collective services are services provided by a public sector entity simultaneously to all members of the community that are intended to address the needs of society as a whole.

…

Individual services are goods and services provided to individuals and/or households by a public sector entity that are intended to address the needs of society as a whole.

…

Effective Date

…

111J. **Paragraphs 6A, and AG1–AG25 were added and paragraph 18 was amended by [draft] IPSAS [X] (ED 67), *Collective and Individual Services and Emergency Relief* (Amendments to IPSAS 19), issued in [Month YYYY]. An entity shall apply these amendments for annual financial statements covering periods beginning on or after [MM DD, YYYY]. Earlier application is encouraged. If an entity applies the amendments for a period beginning before [MM DD, YYYY] it shall disclose that fact and apply IPSAS 42, *Social Benefits*, at the same time.**

…

The Application Guidance in Appendix A (paragraphs AG1–AG25) and the section of the Basis for Conclusions discussing *Collective and Individual Services and Emergency Relief* (Amendments to IPSAS 19) (paragraphs BC6–BC24) are added. Because these are new sections, no mark-up has been used.

Appendix A

Application Guidance

This Appendix is an integral part of IPSAS 19

Introduction

AG1. This Appendix provides guidance on accounting for collective and individual services, and emergency relief. These transactions are non-exchange transactions that do not meet the definition of social benefits in IPSAS 42, *Social Benefits* (and are therefore outside the scope of that Standard). This Appendix addresses the question of whether a provision needs to be recognized for these transactions before the services are delivered.

Collective and Individual Services

Scope of Collective and Individual Services

AG2. This Standard defines collective services as services provided by a public sector entity simultaneously to all members of the community that are intended to address the needs of society as a whole. The provision of a collective service to one individual does not reduce the amount available to other individuals; there is no rivalry in the consumption of collective services. Consumption of collective services is usually passive and does not require the explicit agreement or active participation of those benefiting from the service.

AG3. This Standard defines individual services as goods and services provided to individuals and households by a public sector entity that are intended to address the needs of society as a whole. The provision of an individual service to one individual may reduce the amount available to other individuals, or may delay the receipt of those services by some individuals. Consumption of individual services requires the explicit agreement or active participation of those benefiting from the service.

AG4. Public sector entities provide collective and individual services through the labor of their employees or by purchasing goods and services from third party providers.

AG5. Examples of collective services include street lighting and defense. Examples of individual services include public sector healthcare services and education services.

AG6. The following table illustrates the distinction between social benefits, individual services and collective services.

	Social Benefits	**Individual Services**	**Collective Services**
Involves a cash transfer to eligible beneficiaries?	✓	✗	✗
Provided to individuals and/or households rather than to a community?	✓	✓	✗
Intended to address the needs of society as a whole?	✓	✓	✓

AG7. Social benefits, individual services and collective services all address the needs of society as a whole. Collective services are provided to a community rather than to individuals, which distinguishes them from individual services and social benefits. Individual services involve the delivery of services to individuals and/or households, which distinguishes them from social benefits that involve cash transfers (including cash equivalents such as pre-paid debit cards). Conversely, emergency services (as outlined in paragraphs AG17–AG25) address the needs of specific individuals or households, when emergency events arise.

AG8. In some jurisdictions, individuals may pay for services, for example healthcare, and subsequently be reimbursed by a public sector entity. The substance of these reimbursements is that the public sector entity is paying for the services, and the transaction is an individual service rather than a social benefit.

AG9. In some jurisdictions, a public sector entity may provide vouchers to individuals and households that can be subsequently exchanged for specific goods or services. The provider of the goods or services will be reimbursed by the public sector entity. The substance of these transactions is that the public sector entity is paying for the goods or services, and the transaction is an individual service rather than a social benefit.

No Provision Recognized for Collective Services before the Services are Delivered

AG10. Collective services are ongoing activities of the public sector entity that delivers the services. Paragraph 26 of this Standard states that “no provision is recognized for costs that need to be incurred to continue an entity’s ongoing activities in the future”. Consequently, any obligations that may arise for collective services are not independent of the entity’s future actions, and in accordance with the principles of this Standard, no provision is recognized for the intention to deliver such services.

AG11. In delivering collective services, a public sector entity incurs expenses and acquires resources through exchange transactions. Examples include the electricity used in delivering street lighting, the salaries paid to acquire the services of defense staff, the acquisition of non-current assets used in delivering those services, and the purchase of collective services from a third party provider. These exchange transactions are accounted for in accordance with other IPSAS.

No Provision Recognized for Individual Services before the Services are Delivered

AG12. Similarly, the delivery of individual services represents ongoing activities of the public sector entity that provides the services. The delivery of individual services results in the public sector entity incurring expenses and acquiring resources through exchange transactions.

AG13. The public sector entity uses these resources to deliver services to specific individuals and/or households in non-exchange transactions. Where individuals and/or households access individual services, the entity may have a number of future obligations relating to the delivery of these individual services. Such obligations are an aspect of the ongoing activities of the public sector entity. Similar to collective services, any obligations that may arise for individual services are not independent of the entity's future actions, and in accordance with the principles of this Standard, no provision is recognized for the intention to deliver such services prior to individuals and/or households accessing the services.

Presentation and Disclosure of Collective Services and Individual Services

AG14. An entity shall present and disclose information about collective services and individual services in accordance with other IPSAS, including IPSAS 1, *Presentation of Financial Statements*, and IPSAS 2, *Cash Flow Statements*.

AG15. IPSAS 1 requires an entity to "present, either on the face of the statement of financial performance or in the notes, an analysis of expenses using a classification based on either the nature of expenses or their function within the entity, whichever provides information that is faithfully representative and more relevant."

AG16. Where information is presented based on the nature of expenses, collective services and individual services will be included in items such as employee benefit costs. Where information is presented based on their function within the entity, collective services and individual services may be presented as individual line items, or amalgamated with similar items depending upon their materiality.

Emergency Relief

Scope of Emergency Relief

AG17. Governments and other public sector entities (which includes international organizations) may deliver emergency relief to individuals and/or households who have been adversely affected by circumstances that are not related to social risks (as defined in IPSAS 42), for example:

(a) Natural disasters such as flooding, earthquakes, food shortages and volcanic eruptions; and

(b) The displacement of individuals and/or households as a result of war, civil commotion or economic failure.

AG18. Goods and services delivered through emergency relief do not address the needs of society as a whole. This distinguishes emergency relief from collective services and individual services. Emergency relief may be provided in response to specific emergencies. Alternatively, emergency relief may be delivered as an ongoing activity of government (or other public sector entity). An example would be where a government has established an agency with a remit to deliver ongoing emergency relief activities , and where the agency staff is engaged either in delivering emergency relief or in undertaking planning and preparation activities.

AG19. Governments and other public sector entities deliver emergency relief to individuals and/or households through the following types of transactions:

(a) The provision of services;

(b) The provision of goods;

(c) The replacement of assets; and

(d) Cash transfers.

Accounting for Emergency Relief in Response to Specific Emergencies

AG20. The delivery of emergency relief in response to specific emergencies requires an explicit policy decision to be made by a government or other public sector entity. This decision could give rise to a present obligation, requiring the recognition of a provision when the criteria in paragraphs 22–34 of this Standard are satisfied. For example, in these circumstances a present obligation could arise as a result of government announcements, the passing of legislation and other government actions.

AG21. Where an event does not give rise to a present obligation that satisfies the criteria for the recognition of a provision, an entity shall consider whether paragraphs 35–38 of this Standard require the disclosure of a contingent liability. The nature of the obligation may change as a result of later announcements or actions, such as the enactment of legislation. An entity will need to reassess at each reporting date whether the cumulative effect of the decisions and announcements is sufficient to require the recognition of a provision.

Accounting for Emergency Relief Delivered as an Ongoing Activity

AG22. An entity considers the specific circumstances in which emergency relief is being delivered. Where such delivery of emergency relief is an ongoing activity of government (or other public sector entity) and is analogous to the delivery of collective services and/or individual services as set out in paragraphs AG2-AG16, no provision is recognized before the relief is delivered. In other circumstances, an entity considers the requirements of this Standard in determining whether to recognize a provision or disclose a contingent liability.

Presentation and Disclosure of Emergency Relief

AG23. An entity shall present and disclose information about emergency relief in accordance with other IPSAS, including IPSAS 1 and IPSAS 2.

AG24. IPSAS 1 requires an entity to “present, either on the face of the statement of financial performance or in the notes, an analysis of expenses using a classification based on either the nature of expenses or their function within the entity, whichever provides information that is faithfully representative and more relevant.”

AG25. Where information is presented based on the nature of expenses, emergency relief will be included in items such as employee benefit costs or inventory expenses (for example, donated goods). Where information is presented based on its function within the entity, emergency relief may be presented as an individual line item, or amalgamated with similar items depending upon materiality.

…

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 19.

…

Revision of IPSAS 19 as a result of [draft] [ED 67] *Collective and Individual Services and Emergency Relief* (Amendments to IPSAS 19) issued in [Month and Year]

Collective and Individual Services

BC6. When IPSAS 19 was first issued, "provisions and contingent liabilities arising from social benefits provided by an entity for which it does not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of those benefits" were excluded from the scope of the Standard. IPSAS 19 described social benefits in wide terms as "goods, services, and other benefits provided in the pursuit of the social policy objectives of a government. These benefits may include:

(a) The delivery of health, education, housing, transport, and other social services to the community. In many cases, there is no requirement for the beneficiaries of these services to pay an amount equivalent to the value of these services; and

(b) Payment of benefits to families, the aged, the disabled, the unemployed, veterans, and others. That is, governments at all levels may provide financial assistance to individuals and groups in the community to access services to meet their particular needs, or to supplement their income."

BC7. IPSAS 42, *Social Benefits*, was issued in January 2019. IPSAS 42 amended IPSAS 19, which now excludes from its scope social benefits "within the scope of IPSAS 42" (i.e., cash transfers (including cash equivalents) provided to mitigate the effect of social risks, rather than the wider range of transactions previously referred to as social benefits). A consequence of this amendment was to bring within the scope of IPSAS 19 any provisions and contingent liabilities arising from transactions that were previously excluded from the scope of IPSAS 19, but which are not within the scope of IPSAS 42. The IPSASB therefore agreed to provide guidance on accounting for these transactions. As was previously noted in IPSAS 19, a key issue for stakeholders was whether a provision arose in respect of those transactions.

BC8. Such transactions were referred to in the IPSASB's Consultation Paper (CP), *Accounting for Revenue and Non-Exchange Expenses* (issued in August 2017), as "collective services" and "universally accessible services." (As explained in paragraph BC14, the IPSASB later decided to replace the term "universally accessible services" with the term "individual services.") In that CP, the IPSASB expressed a preliminary view that "non-exchange transactions related to universally accessible services and collective services impose no performance obligations on the resource recipient." As a result, a performance obligation approach to recognizing a non-exchange expense for these transactions would not be appropriate. Respondents to the CP generally supported that preliminary view.

BC9. In the CP, the IPSASB noted that "a public sector entity may have a number of future obligations relating to the provision of universally accessible services and collective services. Such obligations are an aspect of the ongoing activities of governments and other public sector entities; however, only present obligations give rise to liabilities. The expected future sacrifice of resources does not of itself mean that there is a present obligation. … Therefore, the IPSASB is of the view that universally accessible services and collective services do not give rise to obligating events and therefore liabilities or expenses do not arise prior to the delivery of those services to beneficiaries."

BC10. Respondents to the CP also generally supported this view, and the IPSASB agreed to provide Application Guidance on accounting for these transactions in line with the approach set out in the CP. The IPSASB agreed that, because liabilities or expenses for the delivery of universally accessible services and collective services do not arise prior to the delivery of those services to beneficiaries, it is appropriate to account for the delivery of these services in accordance with other IPSAS. For example, IPSAS 39, *Employee Benefits*, covers the expenses incurred in employing staff to deliver these services, IPSAS 12, *Inventories*, covers the expenses incurred in delivering goods to individuals and households, and IPSAS 41, *Financial Instruments*, covers the financial liability that may be incurred in acquiring goods or services.

BC11. In agreeing that liabilities or expenses for the delivery of these services do not arise prior to the delivery of the services to beneficiaries, the IPSASB noted that the reasons a provision did not arise for collective services and universally accessible services were not identical. The IPSASB agreed that the guidance should reflect this.

BC12. The IPSASB noted that collective services are ongoing activities of government. Paragraph 26 of IPSAS 19 states that "no provision is recognized for costs that need to be incurred to continue an entity's ongoing activities in the future". It follows that any obligations that may arise for collective services are not independent of the entity's future actions. Consequently, the IPSASB agreed that recognizing a provision for collective services would be contrary to the requirements of paragraph 26 of IPSAS 19.

BC13. The IPSASB therefore agreed that no provision should be recognized for universally accessible services. The IPSASB also noted that universally accessible services are ongoing activities of government, in the same way as collective services, and that recognizing a provision for such services would be contrary to the requirements of paragraph 26 of IPSAS 19.

BC14. In agreeing to provide guidance in line with the approach set out in the CP, the IPSASB noted that some respondents considered that the term "universally accessible services" was confusing. The IPSASB agreed to avoid this term, and instead adopted the term "individual services", which is consistent with the term used in Government Finance Statistics (GFS) and with the term used in the IPSASB's earlier work on social benefits.

BC15. The IPSASB considered whether specific disclosures for collective and individual services were required, and concluded that the existing requirements in IPSAS 1, *Presentation of Financial Statements*, IPSAS 18, *Segment Reporting*, and the various IPSAS dealing with the specific transactions would provide sufficient information to meet users' needs. Consequently, the IPSASB agreed not to require any specific disclosures for collective and individual services.

Emergency Relief

BC16. Emergency relief may have been included in that wide range of social benefits excluded from the scope of IPSAS 19. In developing IPSAS 42 and the CP, the IPSASB identified disaster relief as a type of non-exchange transaction that is outside the scope of IPSAS 42. (As explained in paragraph BC17, the IPSASB later decided to replace the term "disaster relief" with the term "emergency relief.") This is because disaster relief does not address social risks, as explained in IPSAS 42, and addresses the needs of specific individuals and households rather than the needs of society as a whole. Following the amendments to IPSAS 19 made by IPSAS 42 (described in paragraph BC7 above), the IPSASB agreed to provide guidance on accounting for these transactions.

BC17. In developing *Collective and Individual Services and Emergency Relief* (Amendments to IPSAS 19), the IPSASB noted that some governments and other public sector entities provide relief in circumstances other than natural disasters. For example, some governments provide food and shelter to those displaced as a result of civil commotion. The IPSASB considered that the accounting for such relief would be the same as for relief provided following natural disasters. The IPSASB therefore agreed to extend the scope of this guidance to include all emergency relief that does not satisfy the definition of a social benefit in IPSAS 42.

BC18. The IPSASB noted that, in general, emergency relief is not an ongoing activity of government (or other public sector entity) and that paragraph 26 of IPSAS 19 does not apply. However, depending on the circumstances, a provision may need to be recognized or a contingent liability disclosed.

BC19. The IPSASB noted that the delivery of such emergency relief requires a specific policy decision to be made by a government or other public sector entity. The communication of this decision, which may be when legislation is enacted, may (individually or in combination with other actions) give rise to a present legal or constructive obligation whereby it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation.

BC20. The IPSASB reviewed the requirements of IPSAS 19 regarding the recognition and measurement of provisions, to determine whether these requirements provided sufficient guidance for entities to assess whether a provision should be recognized for emergency relief that is not an ongoing activity of government (or other public sector entity). The IPSASB concluded that the requirements of IPSAS 19, including the additional guidance provided in paragraphs AG17–AG25, were sufficient for entities to assess whether a provision should be recognized for emergency relief that is not an ongoing activity of government (or other public sector entity). The IPSASB therefore agreed not to develop any further requirements.

BC21. The IPSASB noted, however, that in some jurisdictions, emergency relief is delivered as an ongoing activity of government (or other public sector entity). An example would be where a government has established an agency with a remit to deliver emergency relief, and where the agency staff is engaged either in delivering the emergency relief or in undertaking planning and preparation activities.

BC22. In such circumstances, the IPSASB concluded that an entity should consider whether the delivery of the emergency relief is analogous to delivering collective services or individual services. Where the entity concludes that the emergency relief is analogous to delivering collective services or individual services, the IPSASB agreed that the entity should account for the use of the resources as it delivers emergency relief. No provision need be recognized for emergency relief delivered as part of the ongoing activities of government (or other public sector entity).

BC23. Conversely, where the entity concludes that the emergency relief is not analogous to delivering collective services or individual services, a provision may need to be recognized or a contingent liability disclosed.

BC24. The IPSASB also considered whether specific disclosures for emergency relief were required. The IPSASB noted that in many cases, emergency relief will be material either because of the amounts involved or because of its nature. The IPSASB therefore concluded that the existing requirements in IPSAS 1, IPSAS 18 and IPSAS 19 would provide sufficient information to meet users' needs. Consequently, the IPSASB agreed not to require any specific disclosures for emergency relief.

Amendments to IPSAS 42, *Social Benefits*

Paragraphs 4A and 35A are added. New text is underlined

…

Scope

…

4A. Collective services and individual services (as defined in IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*) and emergency relief are not social benefits. Guidance on accounting for these transactions is provided in IPSAS 19.

…

Effective Date

…

35A. **Paragraph 5A was added by [draft] IPSAS [X] (ED 67), *Collective and Individual Services and Emergency Relief* (Amendments to IPSAS 19). An entity shall apply this amendment at the same time as it applies *Collective and Individual Services and Emergency Relief*.**

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EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

NZ ACCOUNTING STANDARDS BOARD

Memorandum

Date:	8 March 2019
To:	NZASB Members
From:	Gali Slyuzberg
Subject:	***Uncertainty over Income Tax Treatments* (Proposed Amendments to PBE IAS 12)**

Recommendations[1]

1. We recommend that the Board
   (a) APPROVES for issue NZASB Exposure Draft 2019-1 *Uncertainty over Income Tax Treatments* (Proposed Amendments to PBE IAS 12) (agenda item 9.3);
   (b) APPROVES the accompanying Invitation to Comment (ITC) (agenda item 9.2);
   (c) AGREES to propose an effective date of 1 January 2020 (with early application permitted) for the amendments; and
   (d) AGREES a comment period of 90 days for the proposed amendments.

Background

2. The IASB issued IFRIC 23 *Uncertainty over Income Tax Treatments* in June 2017, in response to a query received by the IFRS Interpretations Committee (the Committee) relating to disputed tax treatments. The Committee noted that while IAS 12 *Income Taxes* contained recognition and measurement requirements for tax assets and liabilities, it did not specify how to reflect uncertainty, and entities applied diverse reporting methods when the application of tax law was uncertain. The Committee therefore decided to complement the requirements in IAS 12 by addressing how an entity deals with uncertainty over income tax treatments.

3. In August 2017, the Board issued NZ IFRIC 23 *Uncertainty over Income Tax Treatments* in New Zealand. For for-profit entities, the interpretation is effective for annual reporting periods beginning on or after 1 January 2019.

4. In August 2017, the Board also considered the application of the *Policy Approach to Developing the Suite of PBE Standards* (PBE Policy Approach) to NZ IFRIC 23, and agreed to propose the incorporation of NZ IFRIC 23 into PBE IAS 12 *Income Taxes.*[2]

5. Although the initial plan was to include this proposal in the *2018 Omnibus Amendments to PBE Standards*, it was inadvertently omitted. Therefore, we are seeking approval at this

[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® Standards, IFRIC® Interpretations and IASB® papers).

[2] As documented in agenda item 11.4 of the NZASB meeting on 2 August 2017, and the related minutes.

meeting to issue an exposure draft (ED) and ITC proposing to incorporate NZ IFRIC 23 into PBE IAS 12 by adding an appendix to PBE IAS 12.

6. Please note that some information in this memo was presented to the Board at the August 2017 meeting, as part of the process to approve NZ IFRIC 23. Considering the length of time since that meeting, this information is repeated here as a reminder.

Key proposals in the ED

7. The proposed amendments to PBE IAS 12 are based on NZ IFRIC 23 and provide guidance on how an entity applies the measurement and recognition requirements of PBE IAS 12 when there is uncertainty over income tax treatments. The proposed amendments address:
   (a) whether an entity considers uncertain tax treatments separately;
   (b) the assumptions an entity makes about the examination of tax treatments by taxation authorities;
   (c) how an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates; and
   (d) how an entity considers changes in facts and circumstances.

Reasons for the proposed amendments

8. In August 2017, the Board considered the application of the PBE Policy Approach to NZ IFRIC 23. The following points were considered by the Board.
   (a) The IASB issued IFRIC 23 in response to a request for clarification and because it had observed diversity in practice. Although few PBEs pay income tax, those that do could encounter the issues addressed by NZ IFRIC 23. The interpretation could therefore reduce diversity. This could be seen as contributing to higher quality reporting by PBEs and minimising mixed group issues. Having said this, we are not aware of how frequently PBEs encounter such issues, nor of the extent of diversity in practice.
   (b) The interpretation could be incorporated within PBE Standards (as an appendix to PBE IAS 12)[3] without affecting the coherence of the suite of PBE Standards.
   (c) Although the guidance in NZ IFRIC 23 could be seen as a minor amendment (which would not necessarily warrant a change to PBE Standards), the Board has previously indicated its preference for keeping PBE IAS 12 aligned with NZ IAS 12 *Income Taxes*.[4]

9. As part of the Board's due process to approve NZ IFRIC 23, the Board considered a comment letter from a New Zealand constituent, which queried the need for the interpretation and expressed concern that the interpretation could lead to preparers taking an excessively conservative approach in the assumptions and judgements made. However, that respondent did not comment directly to the IASB, and other international respondents to the IASB did not

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[3] There are no separate interpretations in PBE Standards. Interpretations are incorporated into the relevant PBE Standard as an appendix to the standard.

[4] For example, in March 2016, the Board agreed to incorporate the amendments set out in *Recognition of Deferred Tax Assets for Unrealised Losses* (Amendments to IAS 12) into PBE IAS 12.

identify similar concerns. Therefore, this comment did not result in amendments to NZ IFRIC 23 and did not prevent the issue of that interpretation in New Zealand. While the comments in the abovementioned letter could also apply to PBEs, we do not consider that these comments outweigh the reasons outlined in paragraph 8 above that support the incorporation of NZ IFRIC 23 into PBE Standards.

RDR concessions

10. The ED provides application guidance regarding certain existing disclosure requirements in PBE IAS 12 and PBE IPSAS 1 *Presentation of Financial Statements*, albeit the application guidance relates specifically to uncertainty over income tax treatments (see paragraphs B18 and B19 of the ED). There are no RDR concessions for those paragraphs in PBE IAS 12 and PBE IPSAS 1 that are referenced in the ED.

11. Therefore, we do not propose RDR concessions for the application guidance in the ED. This is consistent with NZ IFRIC 23.

Illustrative examples

12. NZ IFRIC 23 is accompanied by non-integral illustrative examples. We propose not to repeat these examples in PBE IAS 12, but to explain in the Basis for Conclusion that these examples can be found in the "other material" to NZ IFRIC 23 (available on the XRB website). This is the approach currently applied in PBE IAS 12 to the non-integral illustrative examples that accompany NZ IAS 12.

Effective date

13. NZ IFRIC 23 is effective for for-profit entities for periods beginning on or after 1 January 2019.

14. To maximise the alignment between NZ IAS 12/NZ IFRIC 23 and PBE IAS 12, and to minimise mixed group issues, we propose that the amendments to PBE IAS 12 be effective for annual financial statements covering periods beginning on or after 1 January 2020, with early application permitted.

Comment period

15. If the Board agrees to issue the ED, we propose the standard comment period of 90 days, with comments due in late June 2019 (exact date depending on the timing of issuing the ED).

Questions for the Board

Q1. Does the Board agree to issue ED NZASB 2019-1 *Uncertainty over Income Tax Treatments* (Proposed Amendments to PBE IAS 12) and the accompanying ITC?

Q2. Does the Board agree to propose an effective date of 1 January 2020, with early application permitted?

Q3. Does the Board agree to provide a 90-day comment period for the ED?

Q4. Does the Board have any comments on the ED or ITC?

Next steps

16. We will amend the documents to reflect the Board's feedback and issue them for comment. We expect to bring an analysis of submissions to the Board's meeting in August 2019.

Attachments

Agenda item 9.2:	Invitation to Comment on NZASB ED 2019-1
Agenda item 9.3:	NZASB ED 2019-1 *Uncertainty over Income Tax Treatments* (Proposed Amendments to PBE IAS 12)

XRB EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

NZ ACCOUNTING STANDARDS BOARD

NZASB Exposure Draft 2019-1X

Uncertainty over Income Tax Treatments (Proposed Amendments to PBE IAS 12)

(NZASB ED 2019-1)

Invitation to Comment

March 2019

PO Box 11250
Manners St Central, Wellington 6142
New Zealand
http://www.xrb.govt.nz

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Information for respondents

Invitation to Comment

The New Zealand Accounting Standards Board (NZASB)[1] is seeking comments on the specific matters raised in this Invitation to Comment. We will consider all comments before finalising the proposed amendments to PBE IAS 12 *Income Taxes*.

If you want to comment, please supplement your opinions with detailed comments, whether supportive or critical of the proposals, as both supportive and critical comments are essential to a balanced view.

Comments are most useful if they indicate the specific paragraph to which they relate, contain a clear rationale and, where applicable, provide a suggestion for an alternative. Feel free to comment on only those questions or issues that are relevant to you.

Comments should be submitted electronically using our 'Open for comment' page at: https://www.xrb.govt.nz/accounting-standards/standards-in-development/open-for-comment/.

Please include *Uncertainty over Income Tax Positions* in the subject line and indicate whether the comments are made on your own behalf, or on behalf of a group of people, or an entity.

The closing date for submissions is **Friday, 28th June 2019**.

Publication of submissions, the Official Information Act and the Privacy Act

We intend publishing all submissions on the XRB website (xrb.govt.nz), unless the submission may be defamatory. If you have any objection to publication of your submission, we will not publish it on the internet. However, it will remain subject to the Official Information Act 1982 and, therefore, it may be released in part or in full. The Privacy Act 1993 also applies.

If you have an objection to the release of any information contained in your submission, we would appreciate you identifying the parts of your submission to be withheld, and the grounds under the Official Information Act 1982 for doing so (e.g. that it would be likely to unfairly prejudice the commercial position of the person providing the information).

1 The NZASB is a sub-Board of the External Reporting Board (XRB Board), and is responsible for setting accounting standards.

List of abbreviations

The following abbreviations are used in this Invitation to Comment.

ED	Exposure Draft
IASB	International Accounting Standards Board
IPSASB	International Public Sector Accounting Standards Board
ITC	Invitation to Comment
NZ IFRS	New Zealand equivalents to International Financial Reporting Standards
NZASB	New Zealand Accounting Standards Board, a sub-Board of the External Reporting Board
PBE	Public benefit entity
IPSAS	International Public Sector Accounting Standard

Questions for respondents

		Paragraphs
1	Do you agree with the proposed amendments to PBE IAS 12? If you disagree, please explain why.	10–12
2	Do you agree with the proposed consequential amendments to PBE FRS 47? If you disagree, please explain why.	13
3	Do you agree with the proposed effective date of annual financial statements covering periods beginning on or after 1 January 2020, with early adoption permitted? If you disagree, please explain why.	14
4	Do you have any other comments on the ED?	

1. Introduction

1.1 Background

1. NZASB Exposure Draft 2019-1 *Uncertainty over Income Tax Treatments* (Proposed Amendments to PBE IAS 12) (the ED) contains proposals to incorporate into PBE IAS 12 *Income Taxes* the guidance in NZ IFRIC 23 *Uncertainty over Income Tax Treatments*. NZ IFRIC 23 clarifies how to apply the recognition and measurement requirements in NZ IAS 12 when there is uncertainty over income tax treatments. Although few PBEs pay income taxes, those that do could encounter the issues addressed by NZ IFRIC 23.

2. The NZASB regularly considers new standards, interpretations and amendments issued by the IASB and IPSASB and forms a view on whether those pronouncements should be incorporated in PBE Standards. While the majority of PBE Standards are based on IPSAS, certain PBE Standards, such as PBE IAS 12, are based directly on NZ IFRS for which there is no equivalent IPSAS and the IPSASB is not expected to develop such an IPSAS in the foreseeable future. When the IASB issues a pronouncement that amends (or complements) an NZ IFRS on which a PBE Standard is directly based, the NZASB considers whether the PBE Standard needs to be updated to maintain alignment with the equivalent NZ IFRS.

1.2 Purpose of this Invitation to Comment

3. The purpose of this Invitation to Comment (ITC) and associated ED is to seek comments on the proposal to incorporate NZ IFRIC 23 into PBE IAS 12.

4. When finalised, the proposals will amend the requirements for public benefit entities (PBEs) in Tiers 1 and 2.

1.3 Timeline and next steps

5. Submissions on the ED are due by **28 June 2019**. Information on how to make submissions is provided on page 4 of this Invitation to Comment.

6. After the consultation period ends, we will consider the submissions received, and subject to the comments in those submissions, we expect to finalise and issue the amendments.

2. Overview of Invitation to Comment and ED

2.1 Summary

8. This Invitation to Comment and accompanying ED seek feedback on the proposal to incorporate into PBE IAS 12 *Income Taxes* the guidance in NZ IFRIC 23 *Uncertainty over Income Tax Treatments*.

9. This will be achieved by adding Appendix B to PBE IAS 12.

2.2 Proposed amendments to PBE IAS 12

Appendix B: Uncertainty over Income Tax Treatments

10. The proposed Appendix addresses the following matters when there is uncertainty over income tax treatments:

    (a) whether an entity considers uncertain tax treatments separately;

    (b) the assumptions an entity makes about the examination of tax treatments by taxation authorities;

    (c) how an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates; and

    (d) how an entity considers changes in facts and circumstances.

11. The proposed Appendix also includes application guidance on:

    (a) application of the requirement to reassess a judgement or estimate if the facts and circumstances on which the judgement or estimate was based change; and

    (b) disclosures when there is uncertainty over income tax treatments.

Transition

12. The ED proposes two possible transition methods:

    (a) retrospective application in accordance with PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors*, including restatement of comparative information, if that is possible without hindsight; or

    (b) retrospective application without restatement of comparative information, with the cumulative effect recognised on the date of initial application of the amendments.

Question for respondents

1. Do you agree with the proposed amendments to PBE IAS 12? If you disagree, please explain why.

2.3 Amendments to other PBE Standards

13. The ED proposes to add into PBE FRS 47 *First-Time Adoption of PBE Standards by Entities Other Than Those Previously Applying NZ IFRS* a short-term exemption for first-time adopters of PBE Standards. First-time adopters whose date of transition to PBE Standards is before the proposed effective date of the proposed amendments are not required to present in their first PBE Standards financial statements comparative information that reflects the proposals in this ED.

Question for respondents

2. Do you agree with the proposed consequential amendments to PBE FRS 47? If you disagree, please explain why.

2.4 Effective date and other comments

14. The proposed effective date in the ED is annual financial statements covering periods beginning on or after 1 January 2020, with early adoption permitted.

Question for respondents

3. Do you agree with the proposed effective date of annual financial statements covering periods beginning on or after 1 January 2020, with early adoption permitted? If you disagree, please explain why.
4. Do you have any other comments on the ED?

NZASB EXPOSURE DRAFT 2019-1

Uncertainty over Income Tax Treatments (Proposed Amendments to PBE IAS 12)

This [draft] Standard was issued on [Date] by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 12(a) of the Financial Reporting Act 2013.

This [draft] Standard is a disallowable instrument for the purposes of the Legislation Act 2012, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on [Date].

Reporting entities that are subject to this [draft] Standard are required to apply it in accordance with the effective date, which is set out in Part C.

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

This [draft] Standard proposes to amend PBE IAS 12 *Income Taxes* to incorporate the guidance from NZ IFRIC 23 *Uncertainty over Income Tax Treatments*. NZ IFRIC 23 clarifies how to apply the recognition and measurement requirements in NZ IAS 12 when there is uncertainty over income tax treatments.

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CONTENTS

UNCERTAINTY OVER INCOME TAX TREATMENTS
(PROPOSED AMENDMENTS TO PBE IAS 12)

Part A: Introduction

This [draft] Standard incorporates into PBE IAS 12 *Income Taxes* the guidance from NZ IFRIC 23 *Uncertainty over Income Tax Treatments*.

The amendments clarify how to apply the recognition and measurement requirements in PBE IAS 12 when there is uncertainty over income tax treatments. In such a circumstance, an entity shall recognise and measure its current or deferred tax asset or liability applying the requirements in PBE IAS 12 based on taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates determined applying this guidance.

Part B: *Uncertainty over Income Tax Treatments*

Scope

This [draft] Standard applies to Tier 1 and Tier 2 public benefit entities.

Amendments to PBE IAS 12 *Income Taxes*

Paragraphs 88A and preceding headings and paragraph 98.8 are added.

Transition

Uncertainty over Income Tax Treatments (Appendix B)

88A On initial application, an entity shall apply Appendix B either:

(a) Retrospectively applying PBE IPSAS 3, if that is possible without the use of hindsight; or

(b) Retrospectively with the cumulative effect of initially applying Appendix B recognised at the date of initial application. If an entity selects this transition approach, it shall not restate comparative information. Instead, the entity shall recognise the cumulative effect of initially applying the Interpretation as an adjustment to the opening balance of accumulated comprehensive revenue and expense (or other component of net assets/equity, as appropriate). The date of initial application is the beginning of the annual reporting period in which an entity first applies Appendix B.

Effective Date

…

98.8 *Uncertainty over Income Tax Treatments* (Amendments to PBE IAS 12), issued in [Date], added paragraphs 88A and Appendix A. An entity shall apply these amendments for annual financial statements covering periods beginning on or after 1 January 2020. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact.

The Application Guidance is renamed Appendix A and the paragraphs are renumbered as A1 etc rather than AG1 etc. New text is underlined and deleted text is struck through.

<u>**Appendix A**</u>

Application Guidance—Changes in the Tax Status of an Entity or its Owners

This Application Guidance forms an integral part of PBE IAS 12

A~~G~~1. […]

A~~G~~2. […]

A~~G~~3. […]

Appendix B is added.

Appendix B

Application Guidance—Uncertainty over Income Tax Treatments

This Appendix is an integral part of PBE IAS 12.

Introduction

B1. PBE IAS 12 *Income Taxes* specifies requirements for current and deferred tax assets and liabilities. An entity applies the requirements in PBE IAS 12 based on applicable tax laws.

B2. It may be unclear how tax law applies to a particular transaction or circumstance. The acceptability of a particular tax treatment under tax law may not be known until the relevant taxation authority or a court takes a decision in the future. Consequently, a dispute or examination of a particular tax treatment by the taxation authority may affect an entity's accounting for a current or deferred tax asset or liability.

B3. In this Appendix:

(a) 'tax treatments' refers to the treatments used by an entity or that it plans to use in its income tax filings.

(b) 'taxation authority' refers to the body or bodies that decide whether tax treatments are acceptable under tax law. This might include a court.

(c) an 'uncertain tax treatment' is a tax treatment for which there is uncertainty over whether the relevant taxation authority will accept the tax treatment under tax law. For example, an entity's decision not to submit any income tax filing in a tax jurisdiction, or not to include particular income in taxable profit, is an uncertain tax treatment if its acceptability is uncertain under tax law.

Scope

B4. This Appendix clarifies how to apply the recognition and measurement requirements in NZ IAS 12 when there is uncertainty over income tax treatments. In such a circumstance, an entity shall recognise and measure its current or deferred tax asset or liability applying the requirements in PBE IAS 12 based on taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates determined applying this Appendix.

Application of PBE IAS 12 to Uncertain Income Tax Treatments

B5. When there is uncertainty over income tax treatments, this Appendix addresses:

(a) whether an entity considers uncertain tax treatments separately;

(b) the assumptions an entity makes about the examination of tax treatments by taxation authorities;

(c) how an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates; and

(d) how an entity considers changes in facts and circumstances.

Whether an Entity Considers Uncertain Tax Treatments Separately

B6. An entity shall determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments based on which approach better predicts the resolution of the uncertainty. In determining the approach that better predicts the resolution of the uncertainty, an entity might consider, for example, (a) how it prepares its income tax filings and supports tax treatments; or (b) how the entity expects the taxation authority to make its examination and resolve issues that might arise from that examination.

B7. If, applying paragraph B6, an entity considers more than one uncertain tax treatment together, the entity shall read references to an 'uncertain tax treatment' in this Interpretation as referring to the group of uncertain tax treatments considered together.

Examination by Taxation Authorities

B8. In assessing whether and how an uncertain tax treatment affects the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, an entity shall assume that a taxation authority will examine amounts it has a right to examine and have full knowledge of all related information when making those examinations.

Determination of Taxable Profit (Tax Loss), Tax Bases, Unused Tax Losses, Unused Tax Credits and Tax Rates

B9. An entity shall consider whether it is probable that a taxation authority will accept an uncertain tax treatment.

B10. If an entity concludes it is probable that the taxation authority will accept an uncertain tax treatment, the entity shall determine the taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates consistently with the tax treatment used or planned to be used in its income tax filings.

B11. If an entity concludes it is not probable that the taxation authority will accept an uncertain tax treatment, the entity shall reflect the effect of uncertainty in determining the related taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates. An entity shall reflect the effect of uncertainty for each uncertain tax treatment by using either of the following methods, depending on which method the entity expects to better predict the resolution of the uncertainty:

(a) the most likely amount—the single most likely amount in a range of possible outcomes. The most likely amount may better predict the resolution of the uncertainty if the possible outcomes are binary or are concentrated on one value.

(b) the expected value—the sum of the probability-weighted amounts in a range of possible outcomes. The expected value may better predict the resolution of the uncertainty if there is a range of possible outcomes that are neither binary nor concentrated on one value.

B12. If an uncertain tax treatment affects current tax and deferred tax (for example, if it affects both taxable profit used to determine current tax and tax bases used to determine deferred tax), an entity shall make consistent judgements and estimates for both current tax and deferred tax.

Changes in Facts and Circumstances

B13. An entity shall reassess a judgement or estimate required by this Appendix if the facts and circumstances on which the judgement or estimate was based change or as a result of new information that affects the judgement or estimate. For example, a change in facts and circumstances might change an entity's conclusions about the acceptability of a tax treatment or the entity's estimate of the effect of uncertainty, or both. Paragraphs B15–B17 set out guidance on changes in facts and circumstances.

B14. An entity shall reflect the effect of a change in facts and circumstances or of new information as a change in accounting estimate applying PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors*. An entity shall apply PBE IPSAS 14 *Events after the Reporting Date* to determine whether a change that occurs after the reporting period is an adjusting or non-adjusting event.

B15. In applying paragraph B13, an entity shall assess the relevance and effect of a change in facts and circumstances or of new information in the context of applicable tax laws. For example, a particular event might result in the reassessment of a judgement or estimate made for one tax treatment but not another, if those tax treatments are subject to different tax laws.

B16. Examples of changes in facts and circumstances or new information that, depending on the circumstances, can result in the reassessment of a judgement or estimate required by this Interpretation include, but are not limited to, the following:

(a) examinations or actions by a taxation authority. For example:

(i) agreement or disagreement by the taxation authority with the tax treatment or a similar tax treatment used by the entity;

(ii) information that the taxation authority has agreed or disagreed with a similar tax treatment used by another entity; and

(iii) information about the amount received or paid to settle a similar tax treatment.

(b) changes in rules established by a taxation authority.

(c) the expiry of a taxation authority's right to examine or re-examine a tax treatment.

B17. The absence of agreement or disagreement by a taxation authority with a tax treatment, in isolation, is unlikely to constitute a change in facts and circumstances or new information that affects the judgements and estimates required by this Interpretation.

Disclosure

B18. When there is uncertainty over income tax treatments, an entity shall determine whether to disclose:

(a) judgements made in determining taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates applying paragraph 137 of PBE IPSAS 1 *Presentation of Financial Statements*; and

(b) information about the assumptions and estimates made in determining taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates applying paragraphs 140–144 of PBE IPSAS 1.

B19. If an entity concludes it is probable that a taxation authority will accept an uncertain tax treatment, the entity shall determine whether to disclose the potential effect of the uncertainty as a tax-related contingency applying paragraph 88 of PBE IAS 12.

Paragraph BC6–BC9 and the preceding heading are added.

Basis for Conclusions

Uncertainty over Income Tax Treatments (Appendix B)

BC6. In June 2017 the IASB issued IFRIC 23 *Uncertainty over Income Tax Treatments*. The NZASB subsequently issued this interpretation in August 2017 as NZ IFRIC 23 *Uncertainty over Income Tax Treatments*, which is effective for for-profit entities for periods beginning on or after 1 January 2019. NZ IFRIC 23 clarifies how to apply the recognition and measurement requirements of NZ IAS 12 *Income Taxes* when there is uncertainty over income tax treatments.

BC7. PBE IAS 12 *Income Taxes* is based on NZ IAS 12. In [Date], the NZASB issued *Uncertainty over Income Tax Treatments* (Amendments to PBE IAS 12) which incorporated the guidance from NZ IFRIC 23 as Appendix B to this Standard. The NZASB noted that some public benefit entities may pay income tax, either directly, or through their controlled entities and that this guidance would be useful for public benefit entities.

BC8. When developing IFRIC 23, the IFRS Interpretations Committee observed that retrospective application of IFRIC 23 without the use of hindsight would often be impossible for entities. Consequently, IFRIC 23 and NZ IFRIC 23 do not require the restatement of comparative information when an entity first applies the guidance. However, retrospective application is permitted if that is possible without the use of hindsight. The same transitional provisions are included in PBE IAS 12 with regard to Appendix B.

BC9. Illustrative examples on the application of Appendix B are available in the additional material for NZ IFRIC 23 *Uncertainty over Income Tax Treatments* on the XRB website at www.xrb.govt.nz.

Amendments to other Standards

Amendment to PBE FRS 47 *First-time Adoption of PBE Standards by Entities Other Than Those Previously Applying NZ IFRS*

Paragraph 42.8 is added.

42.8 *Uncertainty over Income Tax Treatments* (Amendments to PBE IAS 12) added paragraph D4. An entity shall apply that amendment when it applies *Uncertainty over Income Tax Treatments* (Amendments to PBE IAS 12).

In Appendix D, paragraph D4 and its related heading are added.

Uncertainty over Income Tax Treatments

D4. A first-time adopter whose date of transition to PBE Standards is before [date[1]] may elect not to reflect the application of Appendix B of PBE IAS 12 (Uncertainty over Income Tax Treatments) in comparative information in its first PBE Standards financial statements. An entity that makes that election shall recognise the cumulative effect of applying Appendix B of PBE IAS 12 as an adjustment to the opening balance of accumulated comprehensive revenue and expense (or other component of net assets/equity, as appropriate) at the beginning of its first PBE Standards reporting period.

Paragraphs BC11, BC12 and the preceding heading are added.

Basis for Conclusions

Uncertainty over Income Tax Treatments (Amendments to PBE IAS 12)

BC11. When developing IFRIC 23 *Uncertainty over Income Tax Treatments*, the IFRS Interpretations Committee observed that retrospective application of IFRIC 23 without the use of hindsight would often be impossible for entities. The Committee also observed that if a first-time adopter's date of transition to IFRSs is before the date IFRIC 23 is issued, the first-time adopter may face the same hindsight difficulties as entities that already apply IFRS Standards. Consequently, IFRS 1 provides that first-time adopters whose date of transition to IFRSs is before 1 July 2017 are not required to present in their first IFRS financial statements comparative information that reflects IFRIC 23.

BC12. The same provision was included in NZ IFRS 1 when NZ IFRIC 23 *Uncertainty over Income Tax Treatments* was issued in August 2017. The NZASB therefore decided to include this provision in PBE FRS 47 when issuing *Uncertainty over Income Tax Treatments* (Amendments to PBE IAS 12), albeit referring to a date of transition to PBE Standards before [date[1]].

Part C: Effective Date

The amendments in this Standard are effective for annual financial statements covering periods beginning on or after 1 January 2020. Earlier application is permitted.

[1] This date is proposed to be around one month following the date of issue of *Uncertainty over Income Tax Treatments* (Amendments to PBE IAS 12).