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Treasury of the Republic of Cyprus.

# FINANCIAL INSTRUMENTS

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# 1. INTRODUCTION

## 1.1 FINANCIAL INSTRUMENTS

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

A financial asset is any asset that is:

- Cash;
- An equity instrument of another entity;
- A contractual right:
  - to receive cash or another financial asset from another entity; or
  - to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or
- A contract that will or may be settled in the entity's own equity instruments and is:
  - a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or
  - 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.

A financial liability is any liability that is:

- A contractual obligation:
  - to deliver cash or another financial asset to another entity; or
  - to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or
- A contract that will or may be settled in the entity's own equity instruments and is:
  - 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
  - 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.

An equity instrument is:

Any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

A financial instrument has two sides, one party to the contract must have a financial asset and the other party to the contract must have a financial liability or an equity instrument. For example:

- When an entity raises capital by issuing equity shares, the subscriber (holder) to the shares has a financial asset (the investment) and the issuer of the shares has an equity instrument (the equity share capital); or
- When an entity raises capital by issuing bonds, the subscriber to the bonds has a financial asset (the investment) and the issuer of the shares has a financial liability (the bonds); or
- When a credit invoice is issued on the sale of goods, the entity that has sold the goods has a financial asset (the receivable) and the purchaser of the goods has a financial liability (the payable).

## **1.2 OBJECTIVE**

The objective of this accounting policy is to establish the principles for the presentation, recognition, measurement and disclosure of financial instruments. The aim of this policy is to provide technical accounting guidance for the preparation of financial statements, so as to enable the financial statements to give a true and fair view of the financial performance and financial position of the public sector entity. The aforementioned policy is prepared following guidance from all relevant International Public Sector Accounting Standards (IPSASs).



## 1.3 SCOPE

### 1.3.1 PRESENTATION

1. The presentation principles as described in Chapter 2 of this accounting policy shall be applied by all public sector 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 the relevant Accounting Policies (Separate Financial Statements, Consolidated Financial Statements or Investments in Associates and Joint Ventures). However, in some cases, the aforementioned Accounting Policies require or permit an entity to account for an interest in a controlled entity, associate, or joint venture using the principles of Chapters 3, 4 and 5; in those cases, entities shall apply the requirements of this policy. Entities shall also apply this policy to all derivatives linked to interests in controlled entities, associates, or joint ventures;
  - (b) Employers' rights and obligations under employee benefit plans (see Accounting Policy on Employee Benefits);
  - (c) Obligations arising from insurance contracts. However, this policy applies to:
    - (i) Derivatives that are embedded in insurance contracts if Chapters 3, 4 and 5 require the entity to account for them separately; and
    - (ii) Financial guarantee contracts, if the issuer applies Chapters 3, 4 and 5 in recognising and measuring the contracts.In addition to (i) and (ii) above, an entity may apply this policy to insurance contracts which involve the transfer of financial risk.
  - (d) Financial instruments that are within the scope of the international accounting standard dealing with insurance contracts because they contain a discretionary participation feature. The issuer of these instruments is exempt from applying to these features paragraphs 2.1 and 2.2 of this policy regarding the distinction between financial liabilities and equity instruments. However, these instruments are subject to all other requirements of this policy. Furthermore, this policy applies to derivatives that are embedded in these instruments.
  - (e) Financial instruments, contracts and obligations under share-based payment transactions to which the relevant international accounting standard dealing with share-based payments applies, except for:
    - (i) Contracts within the scope of paragraphs 2 below, to which this policy applies;or

- (ii) Paragraph 2.3 of this policy, which shall be applied to treasury shares purchased, sold, issued, or cancelled in connection with employee share option plans, employee share purchase plans, and all other share-based payment arrangements.
- 2. This policy shall be applied to those contracts to buy or sell a non-financial item that can be settled net in cash (i.e. one party paying the other an amount of cash equivalent to the value of the contract, with no physical delivery of the underlying item, e.g. futures contracts that are 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 policy shall be applied to those contracts that an entity designates as measured at fair value through surplus or deficit in accordance with paragraph 1.3.2(5).

### **1.3.2 RECOGNITION AND MEASUREMENT**

- 1. The recognition and measurement principles as described in Chapters 3, 4, 5 and 6 of this policy shall be applied by all public sector 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 the relevant Accounting Policies (Separate Financial Statements, Consolidated Financial Statements, or Investments in Associates and Joint Ventures). However, in some cases the aforementioned Accounting Policies 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 accounting policy. Entities shall also apply this accounting policy to all 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.
  - (b) Rights and obligations under leases to which the Accounting Policy on 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 accounting policy;
    - (ii) Lease liabilities recognised by a lessee are subject to the derecognition requirements in paragraph 3.4(1) of this accounting policy; and

- (iii) Derivatives that are embedded in leases are subject to the embedded derivatives requirements of this accounting policy.
- (c) Employers' rights and obligations under employee benefit plans, to which the Accounting Policy on Employee Benefits applies.
- (d) Financial instruments issued by the entity that meet the definition of an equity instrument (including options and warrants) or that are required to be classified as an equity instrument in accordance with paragraph 2.1.2.1 or paragraph 2.1.2.2. However, the holder of such equity instruments shall apply this accounting policy 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 1.4; or
  - (ii) A contract that is within the scope of relevant international accounting standard dealing with insurance contracts because it contains a discretionary participation feature.

This accounting policy applies to a derivative that is embedded in a contract if the derivative is not itself an insurance contract (see paragraph 4.3). An entity applies this accounting policy to financial guarantee contracts, but shall apply the relevant international accounting standard dealing with insurance contracts if the issuer elects to apply that standard in recognising and measuring them. Notwithstanding (i) above, an entity may apply this accounting policy 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 acquired operation that will result in a public sector combination to which the Accounting Policy on Public Sector Combinations applies 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 described in paragraph 1.3.2(3). However, an issuer of loan commitments shall apply the impairment requirements of this policy to loan commitments that are not otherwise within the scope of this policy. Also, all loan commitments are subject to the derecognition requirements of this policy.
- (h) Financial instruments, contracts and obligations under share-based payment transactions, except for contracts within the scope of paragraphs 4 and 5 below of this policy to which this policy 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 Accounting Policy on Provisions, Contingent Liabilities and Contingent Assets, or for which, in an earlier period, it recognised a provision in accordance with the aforementioned policy.
  - (j) The initial recognition and initial measurement of rights and obligations arising from non-exchange revenue transactions to which the Accounting Policy on Revenue from Non-Exchange Transactions (Taxes and Transfers) applies. A liability that is initially recognised as a result of conditions imposed on the use of an asset is outside the scope of this policy and is dealt with in the Accounting Policy on Revenue from Non-Exchange Transactions (Taxes and Transfers). After initial recognition, if circumstances indicate that recognition of a liability in accordance with the Accounting Policy on Revenue from Non-Exchange Transactions (Taxes and Transfers) is no longer appropriate, an entity considers whether a financial liability should be recognised in accordance with this policy. Other liabilities that may arise from non-exchange revenue transactions are recognised and measured in accordance with this policy if they meet the definition of a financial liability as per paragraph 1.4 and Chapter 2.
  - (k) Rights and obligations under service concession arrangements to which the Accounting Policy on Service Concession Assets: Grantor applies. However, financial liabilities recognised by a grantor under the financial liability model are subject to the derecognition provisions of this policy.
2. The impairment requirements of this policy shall be applied to those rights arising from transactions under Revenue from Exchange Transactions and Revenue from Non-Exchange Transactions (Taxes and Transfers) which give rise to financial instruments for the purposes of recognising impairment gains or losses.
  3. The following loan commitments are within the scope of this policy:
    - (a) Loan commitments that the entity designates as financial liabilities at fair value through surplus or deficit (see paragraph 4.2.2). An entity that has a past practice of selling the assets resulting from its loan commitments shortly after origination shall apply this policy 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 4.2.1(d)).

4. This policy 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 policy shall be applied to those contracts that an entity designates as measured at fair value through surplus or deficit in accordance with paragraph 5 below.
5. 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 policy (see paragraph 4 above).

### **1.3.3 DISCLOSURES**

1. The disclosure principles as described in Chapter 7 of this policy shall be applied by all public sector 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 the relevant Accounting Policies (Separate Financial Statements, Consolidated Financial Statements, or Investments in Associates and Joint Ventures). However, in some cases, the aforementioned Accounting Policies require or permit an entity to account for an interest in a controlled entity, associate, or joint venture using the classification and measurement principles of this accounting policy; in those cases, entities shall apply the requirements of this policy. Entities shall also apply this policy to all derivatives linked to interests in controlled entities, associates, or joint ventures unless the derivative meets the definition of an equity instrument as described in Chapter 2.
  - (b) Employers' rights and obligations arising from employee benefit plans, to which the Accounting Policy on Employee Benefits applies.

(c) Rights and obligations arising under insurance contracts. However, this policy applies to:

- (i) Derivatives that are embedded in insurance contracts if the requirements of this policy requires the entity to account for them separately; and
- (ii) An issuer of financial guarantee contracts if the issuer applies this policy in recognising and measuring the contracts.

In addition to (i) and (ii) above, an entity may apply this policy 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 accounting standard dealing with share-based payment applies, except for contracts within the scope of paragraph 1.3.2(5).

(e) Instruments that are required to be classified as equity instruments in accordance with paragraph 2.1.2.

2. The disclosure principles apply to recognised and unrecognised financial instruments. Recognised financial instruments include financial assets and financial liabilities that are within the scope of this policy. Unrecognised financial instruments include some financial instruments that, although outside the recognition and measurement scope of this policy, are within the disclosure scope of this policy (such as some loan commitments).
3. The disclosure principle apply to contracts to buy or sell a non-financial item that are within the recognition and measurement scope of this policy.
4. The credit risk disclosure requirements in paragraphs 7.3.2.1.1 - 7.3.2.1.4 apply to those for receivables that result from exchange transactions that are within the scope of the Accounting Policy on Revenue from Exchange Transactions and non-exchange transactions within the scope of the Accounting Policy on Revenue from Non-Exchange Transactions (Taxes and Transfers) which give rise to financial instruments for the purpose of recognising impairment gains or losses in accordance with paragraph 1.3.2(2). Any reference to financial assets or financial instruments in these paragraphs shall include those rights unless otherwise specified.

## 1.4 DEFINITIONS

**12-month expected credit losses** 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 **amortised cost of a financial asset or financial liability** 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 **credit-impaired financial asset** 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.

**Credit loss** 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 risk** is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

**Credit risk grades** is a rating of credit risk based on the risk of a default occurring on 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.

**Currency risk** is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

**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 policy 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.

An **equity instrument** is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

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



A **financial asset** is any asset that is

- (a) Cash;
- (b) An equity instrument of another entity;
- (c) A contractual right:
  - (i) to receive cash or another financial asset from another entity; or
  - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or
- (d) A contract that will or may be settled in the entity's own equity instruments and is:
  - (i) a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or
  - (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include puttable financial instruments classified as equity instruments (in accordance with paragraph 2.1.2.1), 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 2.1.2.2), or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.

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

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 unfavorable 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 the 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 2.1.2.1), 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 2.1.2.2), 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 paragraph 2.1.2.

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 4.2.2 or 4.3.2(3).
- (c) It is designated either upon initial recognition or subsequently as at fair value through surplus or deficit in accordance with paragraph 6.7.1.

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 **hedging instrument** is a designated derivative or (for a hedge of the risk of changes in foreign currency exchange rates only) a designated non-derivative financial asset or non-derivative financial liability whose fair value or cash flows are expected to offset changes in the fair value or cash flows of a designated hedged item.

A **hedged item** is an asset, liability, firm commitment, highly probable forecast transaction or net investment in a foreign operation that (a) exposes the entity to risk of changes in fair value or future cash flows and (b) is designated as being hedged.

**Hedge effectiveness** is the degree to which changes in the fair value or cash flows of the hedged item that are attributable to a hedged risk are offset by changes in the fair value or cash flows of the hedging instrument.

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; or
- (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).

**Interest rate risk** is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

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

**Liquidity risk** is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

**Loans payable** are financial liabilities, other than short-term trade payables on normal credit terms.

A **loss allowance** is the allowance for expected credit losses on financial assets measured in accordance with paragraph 4.1.1(2), lease receivables, the accumulated impairment amount for financial assets measured in accordance with paragraph 4.1.1(3) and the provision for expected credit losses on loan commitments and financial guarantee contracts.

**Market risk** is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk, and other price risk.

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.

**Other price risk** is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.

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.

A **puttable instrument** is a financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset or is automatically put back to the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder.

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. An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument. 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.

Any other terms defined in other accounting policies that have been adopted by the government of the Republic of Cyprus, are used in this accounting policy with the same meaning as in those accounting policies.

## 2. PRESENTATION

### 2.1 LIABILITIES AND NETASSETS/EQUITY

The **issuer of a financial instrument** shall classify the instrument, or its component parts, on initial recognition as a **financial liability**, a **financial asset** or an **equity instrument** in accordance with the **substance** of the contractual arrangement and the **definitions** of a financial liability, a financial asset and an equity instrument.

#### 2.1.1 DISTINGUISHING BETWEEN DEBT AND EQUITY

1. A financial instrument will be classified as an **equity instrument** (rather than a financial liability) 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 unfavorable to the issuer.
  - (b) The instrument will or may be settled in the issuer's own equity instruments, and 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 the issuer's own equity instruments do not include instruments that have all the features and meet the conditions described in paragraph 2.1.2.1 or paragraph 2.1.2.2, or instruments that are contracts for the future receipt or delivery of the issuer's own equity instruments.
2. **A critical feature in differentiating a financial liability from an equity instrument** (with the exception of circumstances described in paragraphs 2.1.2.1 and 2.1.2.2) **is the existence of a contractual obligation of one party to the financial instrument** (the issuer) **either to deliver cash or another financial asset to the other party** (the holder) **or to exchange financial assets or financial liabilities with the holder under conditions that are potentially unfavorable to the issuer** (the critical feature of a liability is an obligation to transfer economic benefit). Although the holder of an equity instrument may be entitled to receive a pro rata share of any dividends or similar distributions declared, or distributions of the net assets/equity, the issuer in most cases does not have a contractual obligation to make such distributions because it cannot be required to deliver cash or another financial asset to another party.

3. **The substance of a financial instrument, rather than its legal form, governs its classification on the entity's statement of financial position.** Substance and legal form are commonly consistent, but not always. Some financial instruments take the legal form of equity instruments but are liabilities in substance and others may combine features associated with equity instruments and features associated with financial liabilities.
4. 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 in paragraph 1 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 2.1.2.1 or 2.1.2.2.

## 2.1.2 EXEMPTIONS

### 2.1.2.1 PUTTABLE INSTRUMENTS

- 1 A puttable instrument is a financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset or is automatically put back to the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder.
2. A puttable financial instrument **includes a contractual obligation for the issuer to repurchase or redeem that instrument for cash or another financial asset on exercise of the put**. As an exception to the definition of a financial liability, an instrument that includes such an obligation is classified as an equity instrument if it has **all** of the following features:
  - (a) It entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation; and
  - (b) The instrument is in the class of instruments that is subordinate to all other classes of instruments; and
  - (c) All financial instruments in the class of instruments that is subordinate to all other classes of instruments have identical features; and
  - (d) Apart from the contractual obligation for the issuer to repurchase or redeem the instrument for cash or another financial asset, the instrument does not include any contractual obligation to deliver cash or another financial asset to another entity, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity, and it is not a contract that will or may be settled in the entity's own equity instruments as set out in subparagraph (b) of the definition of a financial liability; and
  - (e) The total expected cash flows attributable to the instrument over the life of the instrument are based substantially on the surplus or deficit, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity over the life of the instrument (excluding any effects of the instrument).
3. For an instrument to be classified as an equity instrument, in addition to the instrument having all the above features, the issuer must have no other financial instrument or contract that has:
  - (a) Total cash flows based substantially on the surplus or deficit, the change in the recognised net assets, or the change in the fair value of the recognised and unrecognised net assets of the entity (excluding any effects of such instrument or contract); and
  - (b) The effect of substantially restricting or fixing the residual return to the puttable instrument holders.

For the purposes of applying this condition, the entity shall not consider non-financial contracts with a holder of an instrument described in paragraph 2.1.2.1(2) above, that have contractual terms and conditions that are similar to the contractual terms and conditions of an equivalent contract that might occur between a non-instrument holder and the issuing entity. If the entity cannot determine that this condition is met, it shall not classify the puttable instrument as an equity instrument.

**2.1.2.2 INSTRUMENTS, OR COMPONENTS OF 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**

1. Some financial instruments include a contractual obligation for the issuing entity to deliver to another entity a pro rata share of its net assets **only on liquidation**. The obligation arises because liquidation either is certain to occur and outside the control of the entity (e.g. a limited life entity) or is uncertain to occur but is at the option of the instrument holder. As an exception to the definition of a financial liability, an instrument that includes such an obligation is classified as an equity instrument if it has **all** of the following features:
  - (a) It entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation.
  - (b) The instrument is in the class of instruments that is subordinate to all other classes of instruments.
  - (c) All financial instruments in the class of instruments that is subordinate to all other classes of instruments must have an identical contractual obligation for the issuing entity to deliver a pro rata share of its net assets on liquidation.
2. For an instrument to be classified as an equity instrument, in addition to the instrument having all the above features, the issuer must have no other financial instrument or contract that has:
  - (a) Total cash flows based substantially on the surplus or deficit, the change in the recognised net assets, or the change in the fair value of the recognised and unrecognised net assets of the entity (excluding any effects of such instrument or contract); and
  - (b) The effect of substantially restricting or fixing the residual return to the puttable instrument holders.

For the purposes of applying this condition, the entity shall not consider non-financial contracts with a holder of an instrument described in paragraph 2.1.2.2(1) that have contractual terms and conditions that are similar to the contractual terms and conditions of an equivalent contract that might occur between a non-instrument holder and the issuing entity. If the entity cannot determine that this condition is met, it shall not classify the instrument as an equity instrument.



### **2.1.3 RECLASSIFICATION OF PUTTABLE INSTRUMENTS AND 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**

1. An entity shall classify a financial instrument as an equity instrument in accordance with paragraph 2.1.2 from the date when the instrument has all the features and meets the conditions set out in those paragraphs. An entity shall reclassify a financial instrument from the date when the instrument ceases to have all the features or meet all the conditions set out in those paragraphs. For example, if an entity redeems all its issued non-puttable instruments and any puttable instruments that remain outstanding have all of the features and meet all the conditions in paragraph 2.1.2.1, the entity shall reclassify the puttable instruments as equity instruments from the date when it redeems the non-puttable instruments.
2. An entity shall account for the reclassification of an instrument in accordance with paragraph 1 above as follows:
  - (a) It shall reclassify an equity instrument as a financial liability from the date when the instrument ceases to have all of the features or meet the conditions in paragraph 2.1.2. The financial liability shall be measured at the instrument's fair value at the date of reclassification. The entity shall recognise in net assets/equity any difference between the carrying value of the equity instrument and the fair value of the financial liability at the date of reclassification.
  - (b) It shall reclassify a financial liability as an equity instrument from the date when the instrument has all of the features and meets the conditions set out in paragraph 2.1.2. An equity instrument shall be measured at the carrying value of the financial liability at the date of reclassification.

#### 2.1.4 CONTINGENT SETTLEMENT PROVISIONS

A financial instrument may require the entity to deliver cash or another financial asset, or otherwise to settle it in such a way that it would be a financial liability, in the **event of the occurrence or non-occurrence of uncertain future events (or on the outcome of uncertain circumstances)** that are beyond the control of both the issuer and the holder of the instrument, such as a change in a stock market index, consumer price index, interest rate, or taxation requirements, or the issuer's future revenues, surplus or deficit, or debt-to-equity ratio. The issuer of such an instrument does not have the unconditional right to avoid delivering cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability). Therefore, it is a financial liability of the issuer unless:

- (a) The part of the contingent settlement provision that could require settlement in cash or another financial asset (or otherwise in such a way that it would be a financial liability) is not genuine;
- (b) The issuer can be required to settle the obligation in cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability) only in the event of liquidation of the issuer; or
- (c) The instrument has all of the features and meets the conditions in paragraph 2.1.2.1.

#### 2.1.5 SETTLEMENT OPTIONS

When a derivative financial instrument gives one party a **choice** over how it is settled (e.g. the issuer or the holder can choose settlement net in cash or by exchanging shares for cash), it is a **financial asset** or a **financial liability**, unless **all of the settlement alternatives** would result in it being an equity instrument.

### 2.2 COMPOUND FINANCIAL INSTRUMENTS

The issuer of a non-derivative financial instrument shall evaluate the terms of the financial instrument to determine whether it contains both a **liability component** and a **net assets/equity component**. Such components shall be classified separately as financial liabilities, financial assets, or equity instruments in accordance with paragraph 2.1.

## 2.3 TREASURY SHARES

If an entity **reacquires its own equity instruments**, those instruments ("Treasury Shares") shall be **deducted from net assets/equity**. **No gain or loss** shall be recognised in surplus or deficit on the purchase, sale, issue, or cancellation of an entity's own equity instruments. Such Treasury Shares may be acquired and held by the entity or by other members of the economic entity. **Consideration** paid or received shall be recognised directly in **net assets/equity**.

## 2.4 INTEREST, DIVIDENDS OR SIMILAR DISTRIBUTIONS, LOSSES AND GAINS

1. Interest, dividends or similar distributions, losses and gains relating to a financial instrument or a component that is a financial liability shall be recognised as **revenue or expense in surplus or deficit**.
2. **Distributions** to holders of an **equity instrument** shall be recognised by the entity directly in **net assets/equity**.
3. **Transaction costs** incurred on transactions in net assets/equity shall be accounted for as a deduction from net assets/equity.

## 2.5 OFFSETTING A FINANCIAL ASSET AND A FINANCIAL LIABILITY

1. 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) Currently has a **legally enforceable right** to set off the recognised amounts; **and**
  - (b) Intends either to **settle on a net basis**, or to **realise the asset and settle the liability simultaneously**.
2. 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 paragraph 3.2.5(1)).

## 3. RECOGNITION & DERECOGNITION

### 3.1 INITIAL RECOGNITION

1. A public sector entity **must recognise** a financial asset or financial liability in its statement of financial position **when, and only when, it becomes a party to the contractual provisions of the instrument.**
2. When an entity first recognises a financial asset, it shall classify it in accordance with paragraph 4.1 and measure it initially in accordance with paragraph 5.1.1.
3. When an entity first recognises a financial liability, it shall classify it in accordance with paragraph 4.2 and measure it initially in accordance with paragraph 5.1.1(1).

### 3.2 DERECOGNITION OF A FINANCIAL ASSET

#### 3.2.1 GENERAL

1. In consolidated financial statements, paragraphs 2-6 below are applied at a consolidated level. Hence, an entity first **consolidates all controlled entities** in accordance with the Accounting Policy on Consolidated Financial Statements and **then applies paragraphs 2-6** below to the resulting economic entity.
2. Before evaluating whether, and to what extent, derecognition is appropriate under paragraphs 3-6 below, an entity must determine 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 3-6 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 3-6 are applied to the interest cash flows; or
    - (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 percent share of all cash flows of a debt instrument, paragraphs 3-6 are applied to 90 percent of those cash flows. If there is more than one counterparty, each counterparty is not required to have a proportionate share of the cash flows provided that the transferring entity has a fully proportionate share; or

(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 percent share of interest cash flows from a financial asset, paragraphs 3-6 are applied to 90 percent 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 3-6 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 percent of cash collections from a financial asset (or a group of financial assets), or (ii) the rights to 90 percent of the cash flows from a group of receivables, but provides a guarantee to compensate the buyer for any credit losses up to 8 percent of the principal amount of the receivables, paragraphs 3-6 are applied to the financial asset (or a group of similar financial assets) in its entirety.

In paragraphs 3-6 below and 3.2.2(1)-(3), 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.

3. 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 4 and 5 below and the transfer qualifies for derecognition in accordance with paragraph 6 below.

(See paragraph 3.3 for regular way sales of financial assets).

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

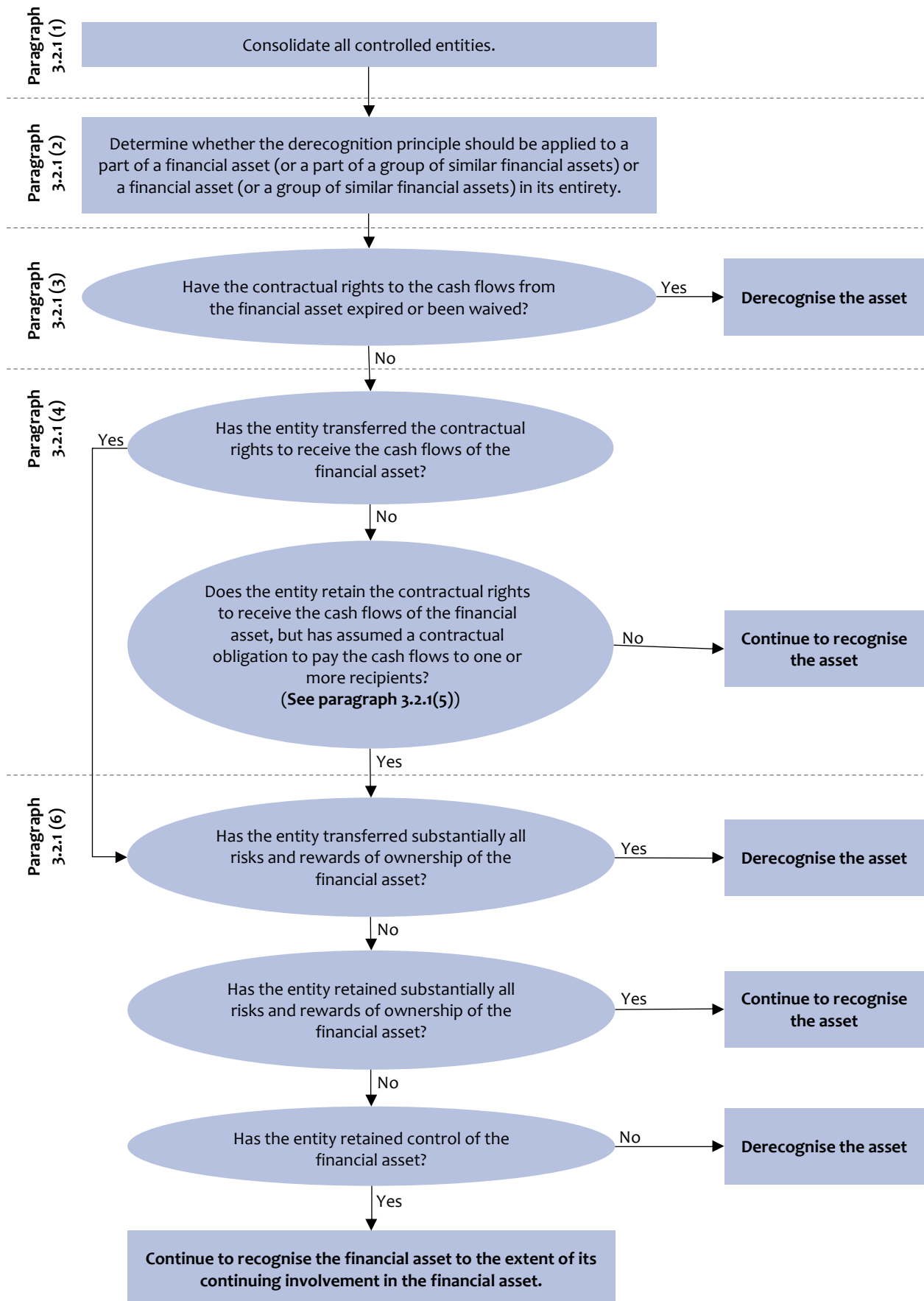
(a) **Transfers** the **contractual rights** to receive the **cash flows** of the financial asset; or

(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 5 below.

5. 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 the Accounting Policy on Presentation of Financial Instruments) 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.
6. When an entity transfers a financial asset (see paragraph 4 above), 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 **must 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 3.2.4(1)).
7. The flowchart below illustrates the procedure as described in paragraphs 1 – 6 above.

## DERECOGNITION OF A FINANCIAL ASSET



### 3.2.2 TRANSFERS THAT QUALIFY FOR DERECOGNITION

1. 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 4 below.
2. 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.
3. 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**.
4. 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 3.2.1(2)(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.



5. 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.

### **3.2.3 TRANSFERS THAT DO NOT QUALIFY FOR DERECOGNITION**

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.

### **3.2.4 CONTINUING INVOLVEMENT IN TRANSFERRED ASSETS**

1. 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 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.

- (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.
2. 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 accounting policy, 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.
  3. 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.
  4. 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 5.8.1(1), and shall not be offset.
  5. 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 3.2.2(5) 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 recognisedshall be recognised in surplus or deficit.
  6. If the transferred asset is measured at amortised cost, the option in this accounting policy to designate a financial liability as at fair value through surplus or deficit is not applicable to the associated liability.

### **3.2.5 ALL TRANSFERS**

- 1 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 2.5).
2. 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) above, the transferor shall continue to carry the collateral as its asset, and the transferee shall not recognise the collateral as an asset.

### **3.3 REGULAR WAY PURCHASE OR SALE OF A FINANCIAL ASSET**

A regular way purchase or sale of a financial asset shall be recognised and derecognised, as applicable, using trade date accounting (the trade date is the date that an entity commits itself to purchase or sell an asset).

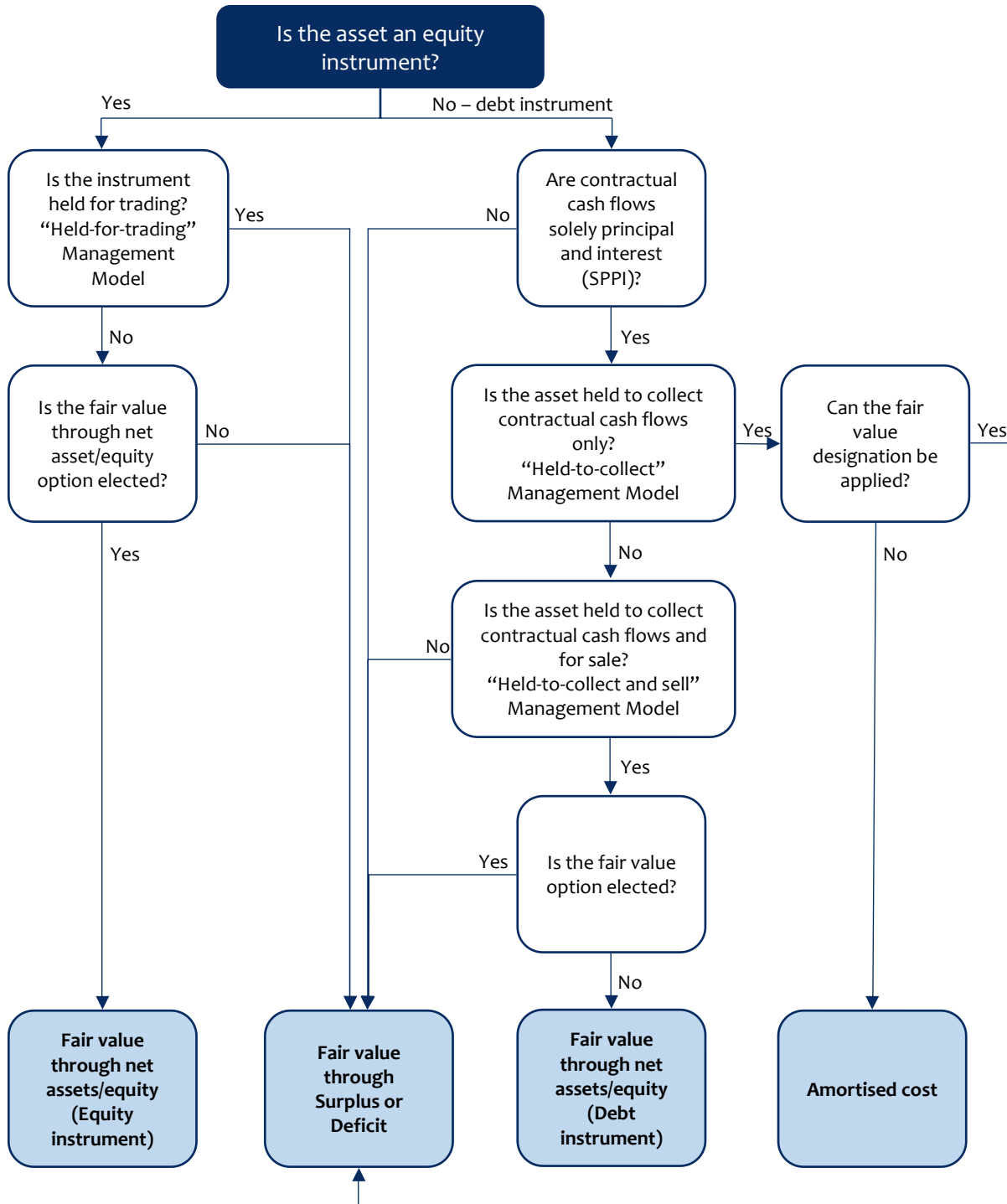
### 3.4 DERECOGNITION OF A FINANCIAL LIABILITY

1. 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**.
2. 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**. For the purpose of this paragraph, 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 percent 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.
3. 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 the Accounting Policy on Revenue from Non-Exchange Transactions (Taxes and Transfers).

# 4. CLASSIFICATION

## 4.1 CLASSIFICATION OF FINANCIAL ASSETS

### 4.1.1 DETERMINING THE CLASSIFICATION OF FINANCIAL ASSETS



Source: At A Glance (Exposure Draft: Financial Instruments)

<https://www.ifac.org/system/files/publications/files/Financial-Instruments-At-a-Glance-final.pdf>

- 1 Unless paragraph 4.1.2 applies, an entity shall classify financial assets as subsequently measured at *amortised cost*, *fair value through net assets/equity* **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.

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 management model 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 realize fair value changes. Similarly, in some circumstances, it may be appropriate to separate a portfolio of financial assets into sub-portfolios 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.

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

2. 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.
  
3. A financial asset shall be measured at **fair value through net assets/equity** 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.
  
4. For the purpose of applying paragraphs 2(b) and 3(b) above:
  - (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).
  - (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 (all of which are consistent with a basic lending arrangement).
  
5. A financial asset shall be measured at **fair value through surplus or deficit** unless it is measured at amortised cost in accordance with paragraph 2 above or at fair value through net assets/equity in accordance with paragraph 3 above. 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 net assets/equity (see paragraph 5.8.2).

#### **4.1.2 OPTION TO DESIGNATE A FINANCIAL ASSET AT FAIR VALUE THROUGH SURPLUS OR DEFICIT**

Despite paragraph 4.1.1, 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.

### **4.2 CLASSIFICATION OF FINANCIAL LIABILITIES**

#### **4.2.1 DETERMINING THE CLASSIFICATION OF FINANCIAL LIABILITIES**

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 3.2.3 and 3.2.4(2) apply to the measurement of such financial liabilities.
- (c) Financial guarantee contracts. After initial recognition, an issuer of such a contract shall (unless paragraphs (a) or (b) above apply) subsequently measure it at the higher of:
  - (i) The amount of the loss allowance determined in accordance with paragraph 5.6; and
  - (ii) The amount initially recognised (see paragraph 5.1.1(1)) less, when appropriate, the cumulative amount of amortisation recognised in accordance with the principles of the Accounting Policy on Revenue from Exchange Transactions.
- (d) Commitments to provide a loan at a below-market interest rate. An issuer of such a commitment shall (unless paragraph (a) above applies) subsequently measure it at the higher of:
  - (i) The amount of the loss allowance determined in accordance with paragraph 5.6; and
  - (ii) The amount initially recognised (see paragraph 5.1.1(1)) less, when appropriate, the cumulative amount of amortisation recognised in accordance with the provisions of Accounting Policy on Revenue from Exchange Transactions.
- (e) Contingent consideration recognised by an acquirer in a public sector combination to which the Accounting Policy on Public Sector Combinations applies. Such contingent consideration shall subsequently be measured at fair value with changes recognised in surplus or deficit.



#### **4.2.2 OPTION TO DESIGNATE A FINANCIAL LIABILITY AT FAIR VALUE THROUGH SURPLUS OR DEFICIT**

An entity may, at initial recognition, **irrevocably** designate a financial liability as measured at **fair value through surplus or deficit** when permitted by paragraph 4.3.2(3), 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; 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 the Accounting Policy on Related Party Disclosures), for example, the entity’s governing body and chief executive officer.

## 4.3 EMBEDDED DERIVATIVES

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.

### 4.3.1 HYBRID CONTRACTS WITH FINANCIAL ASSET HOSTS

If a hybrid contract contains a **host** that is an **asset within the scope of this accounting policy**, an entity shall apply the requirements in paragraph 4.1 to the **entire** hybrid contract.

### 4.3.2 OTHER HYBRID CONTRACTS

1. If a hybrid contract contains a **host** that is **not an asset within the scope of this accounting policy**, an embedded derivative shall be **separated** from the host and accounted for as a derivative under this accounting policy 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;
  - (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).
2. If an embedded derivative is separated, the host contract shall be accounted for in accordance with the appropriate accounting policies. This accounting policy does not address whether an embedded derivative shall be presented separately in the statement of financial position.
3. Despite paragraphs 1 and 2 above, if a contract contains one or more embedded derivatives and the host is not an asset within the scope of this accounting policy, 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.
4. If an entity is required by this accounting policy 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.
  5. 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 4 above applies and the hybrid contract is designated as at fair value through surplus or deficit.

## 4.4 RECLASSIFICATION

1. **When, and only when, an entity changes its management model for financial assets it shall reclassify all affected financial assets in accordance with paragraph 4.1.1. (See also paragraph 5.7).**
2. **An entity shall not reclassify any financial liability.**
3. The following changes in circumstances are not reclassifications for the purposes of paragraphs 1 and 2 above:
  - (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 paragraph 6.7.

## 5. MEASUREMENT

### 5.1 INITIAL MEASUREMENT

#### 5.1.1 FINANCIAL ASSETS AND FINANCIAL LIABILITIES

1. When a financial asset or financial liability is recognised initially, a public sector entity shall measure it 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. In the case of financial assets or financial liabilities at fair value through surplus or deficit, such transaction costs are recognised in surplus or deficit.
2. The **fair value** of a financial instrument on initial recognition is **normally** the **transaction price** (i.e. the fair value of the consideration given or received). 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.

#### 5.1.2 CONCESSIONARY LOANS

1. Concessionary loans are granted to or received by an entity at below market terms. Examples of concessionary loans granted by public sector 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. Entities may receive concessionary loans, for example, from development agencies and other government entities.
2. 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.
3. 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, the 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 paragraph 3.2.

4. 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 5 and 7 below.
5. 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 this accounting policy and the Accounting Policy on Revenue from Non-Exchange Transactions (Taxes and Transfers). 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 paragraph 5.4. 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.
6. 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 the Accounting Policy on Revenue from Non-Exchange Transactions (Taxes and Transfers).
  - (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.
7. After initial recognition at fair value, an entity subsequently assesses the classification of concessionary loans in accordance with paragraph 4.1 and measures concessionary loans in accordance with paragraph 5.2.

### 5.1.3 FINANCIAL GUARANTEES

1. Only **contractual financial guarantees** (or guarantees that are in substance, contractual) are within the scope of this accounting policy. Non-contractual guarantees are not within the scope of this accounting policy as they do not meet the definition of a financial instrument. This accounting policy prescribes recognition and measurement requirements only for the issuer of financial guarantee contracts.
2. In paragraph 1.4, a "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 accounting policy, financial guarantee contracts, like other financial assets and financial liabilities, are required to be initially recognised at fair value. Subsequent measurement for financial guarantee contracts is at the higher of the the amount of the loss allowance determined in accordance with paragraph 5.6 and the amount initially recognised less, when appropriate, cumulative amortisation in accordance with the Accounting Policy on Revenue from Exchange Transactions.
3. 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 paragraph 5.6 and the amount initially recognised, less, when appropriate, cumulative amortisation recognised in accordance with the Accounting Policy on Revenue from Exchange Transactions. 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.

4. 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 fulfillment 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.
5. 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, the Government guarantees a bond issue of a local authority. As the local authority 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 financial performance. 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.

6. 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 the Accounting Policy on Provisions, Contingent Liabilities and Contingent Assets 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 contract 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.



## 5.2 SUBSEQUENT MEASUREMENT OF FINANCIAL ASSETS

1. After initial recognition, an entity shall measure a financial asset in accordance with paragraph 4.1 at:
  - (a) Amortised cost;
  - (b) Fair value through net assets/equity; or
  - (c) Fair value through surplus or deficit.
2. An entity shall apply the impairment requirements in paragraph 5.6 to financial assets that are measured at amortised cost in accordance with paragraph 4.1.1(2) and to financial assets that are measured at fair value through net assets/equity in accordance with paragraph 4.1.1(3).
3. An entity shall apply the hedge accounting requirements in paragraphs 6.5.2-6.5.4 to a financial asset that is designated as a hedged item.

## 5.3 SUBSEQUENT MEASUREMENT OF FINANCIAL LIABILITIES

1. After initial recognition, an entity shall measure a financial liability in accordance with paragraph 4.2.
2. An entity shall apply the hedge accounting requirements in paragraphs 6.5.2-6.5.4 to a financial liability that is designated as a hedged item.

## 5.4 FAIR VALUE MEASUREMENT CONSIDERATIONS

1. The **fair value** is the amount for which an asset could be exchanged, or a liability settled between knowledgeable, willing parties in an arm's length transaction. 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.
2. In determining the fair value of a financial instrument, a public sector entity should consider:
  - (a) Quoted prices in an active market;
  - (b) Valuation techniques making maximum use of market inputs if there is no active market; or
  - (c) Cost less impairment for equity instruments if there is no active market.

## 5.5 AMORTISED COST MEASUREMENT

The **amortised cost of a financial asset or financial liability** 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.

### 5.5.1 FINANCIAL ASSETS

#### 5.5.1.1 EFFECTIVE INTEREST METHOD

1. Interest revenue shall be calculated by using the effective interest method (as defined in paragraph 1.4). 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.
2. 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 1(b) above, 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 1(b) above were applied (such as an improvement in the borrower's credit rating).

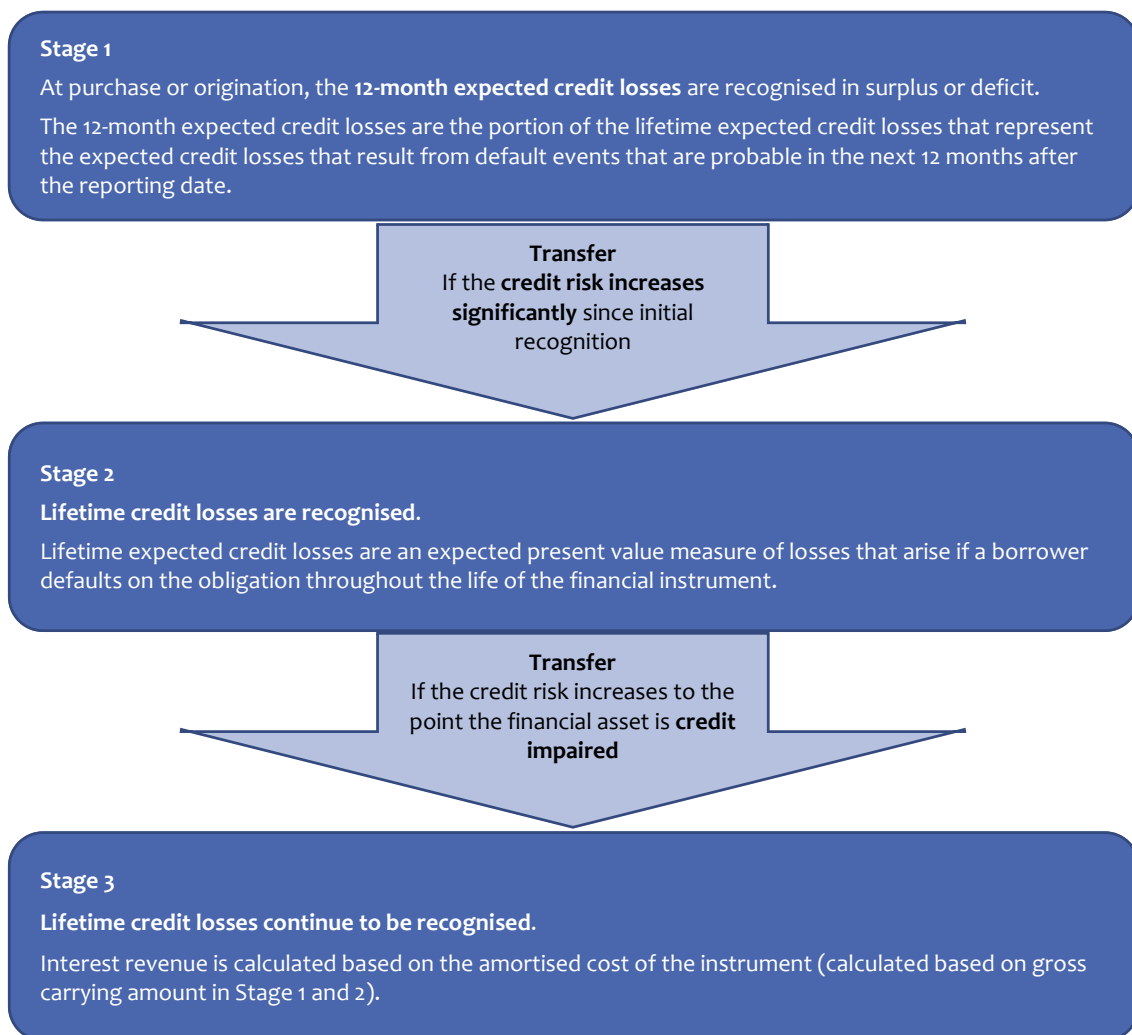
### **5.5.1.2 MODIFICATION OF CONTRACTUAL CASH FLOWS**

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 accounting policy, 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 6.5.2(3). 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.

### **5.5.1.3 WRITE-OFF**

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.

## 5.6 IMPAIRMENT AND UNCOLLECTIBILITY OF FINANCIAL ASSETS



Source: At A Glance (Exposure Draft: Financial Instruments)

<https://www.ifac.org/system/files/publications/files/Financial-Instruments-At-a-Glance-final.pdf>

### 5.6.1 RECOGNITION OF EXPECTED CREDIT LOSSES

#### 5.6.1.1 GENERAL APPROACH

1. An entity shall recognise a **loss allowance** for **expected credit losses** on a financial asset that is measured at amortised cost or at fair value through net assets/equity, a lease receivable, or a loan commitment and a financial guarantee contract to which the impairment requirements apply in accordance with paragraphs 1.3.2(1)(g), 4.2.1(c) or 4.2.1(d).
2. 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 net assets/equity**. However, the **loss allowance** shall be recognised in **net assets/equity** and shall not reduce the carrying amount of the financial asset in the statement of financial position.

3. Subject to paragraphs 5.6.1.4 and 5.6.2, 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.
4. 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.
5. Subject to paragraphs 5.6.1.4 and 5.6.2, 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.
6. 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.
7. 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 3 above 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.
8. 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 accounting policy.

#### **5.6.1.2 DETERMINING SIGNIFICANT INCREASES IN CREDIT RISK**

1. 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.

2. 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.
3. 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.

#### **5.6.1.3 MODIFIED FINANCIAL ASSETS**

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 5.6.1.1(3) 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).

#### **5.6.1.4 PURCHASED OR ORIGINATED CREDIT-IMPAIRED FINANCIAL ASSETS**

1. Despite paragraphs 5.6.1.1(3) and 5.6.1.1(5), 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.

2. 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.

### **5.6.2 SIMPLIFIED APPROACH FOR RECEIVABLES**

1. Despite paragraphs 5.6.1.1(3) and 5.6.1.1(5), 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 Accounting Policy on Revenue from Exchange Transactions and non-exchange transactions within the scope of Accounting Policy on Revenue from Non-Exchange Transactions (Taxes and Transfers).
  - (b) Lease receivables that result from transactions that are within the scope of Accounting Policy on Leases, 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.
2. An entity may select its accounting policy for trade receivables and lease receivables independently of each other.

### **5.6.3 MEASUREMENT OF EXPECTED CREDIT LOSSES**

1. 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.
2. 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.

3. 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.
4. 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.



## 5.7 RECLASSIFICATIONS

1. If an entity reclassifies financial assets in accordance with paragraph 4.4(1), 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. The requirements for reclassifications are set out in this paragraph.
2. 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.
3. 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.
4. If an entity reclassifies a financial asset out of the amortised cost measurement category and into the fair value through net assets/equity 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 net assets/equity. The effective interest rate and the measurement of expected credit losses are not adjusted as a result of the reclassification.
5. If an entity reclassifies a financial asset out of the fair value through net assets/equity 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 net assets/equity 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 net assets/equity but does not affect surplus or deficit and therefore is not a reclassification adjustment. The effective interest rate and the measurement of expected credit losses are not adjusted as a result of the reclassification.
6. If an entity reclassifies a financial asset out of the fair value through surplus or deficit measurement category and into the fair value through net assets/equity measurement category, the financial asset continues to be measured at fair value.

7. If an entity reclassifies a financial asset out of the fair value through net assets/equity 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 net assets/equity is reclassified from net assets/equity to surplus or deficit as a reclassification adjustment at the reclassification date.

## 5.8 GAINS AND LOSSES

### 5.8.1 GENERAL

1. 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 6.5.2-6.5.4);
  - (b) It is an investment in an equity instrument and the entity has elected to present gains and losses on that investment in net assets/equity in accordance with paragraph 5.8.2(1);
  - (c) It is a financial liability designated 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 net assets/equity in accordance with paragraph 5.8.3(1); or
  - (d) It is a financial asset measured at fair value through net assets/equity in accordance with paragraph 4.1.1(3) and the entity is required to recognise some changes in fair value in net assets/equity in accordance with paragraph 5.8.4(1).
2. 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.
3. A gain or loss on a financial asset that is measured at amortised cost and is not part of a hedging relationship (see paragraphs 6.5.2-6.5.4) shall be recognised in surplus or deficit when the financial asset is derecognised, reclassified in accordance with paragraph 5.7(2), through the amortisation process or in order to recognise impairment gains or losses. An entity shall apply paragraphs 5.7(2) and 5.7(4) 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 6.5.2-6.5.4) shall be recognised in surplus or deficit when the financial liability is derecognised and through the amortisation process.
4. 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 6.5.2-6.5.4.

## **5.8.2 INVESTMENTS IN EQUITY INSTRUMENTS**

1. At initial recognition, an entity may make an irrevocable election to present in net assets/equity subsequent changes in the fair value of an investment in an equity instrument within the scope of this accounting policy that is neither held for trading nor contingent consideration recognised by an acquirer in a public sector combination. This decision is done on an instrument by instrument basis.
2. If an entity makes the election in paragraph 1 above, it shall recognise in surplus or deficit dividends or similar distributions from that investment in accordance with paragraph 5.8.1(2).

## **5.8.3 LIABILITIES DESIGNATED AS AT FAIR VALUE THROUGH SURPLUS OR DEFICIT**

1. 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 4.2.2 or paragraph 4.3.2(3) 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 net assets/equity, 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 2 below applies).
2. If the requirements in paragraph 1 above 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.
3. Despite the requirements in paragraphs 1 and 2 above, 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.

## **5.8.4 ASSETS MEASURED AT FAIR VALUE THROUGH NET ASSETS/EQUITY**

1. A gain or loss on a financial asset measured at fair value through net assets/equity in accordance with paragraph 4.1.1(3) shall be recognised in net assets/equity, **except for** impairment gains or losses (see paragraph 5.6) and foreign exchange gains and losses, until the financial asset is derecognised or reclassified. When the financial asset is derecognised the cumulative gain or loss previously recognised in net assets/equity is

reclassified from net assets/equity to surplus or deficit as a reclassification adjustment. If the financial asset is reclassified out of the fair value through net assets/equity measurement category, the entity shall account for the cumulative gain or loss that was previously recognised in net assets/equity in accordance with paragraphs 5.7(5) and 5.7(7). Interest calculated using the effective interest method is recognised in surplus or deficit.

2. As described in paragraph 1 above, if a financial asset is measured at fair value through net assets/equity in accordance with paragraph 4.1.1(3), 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.

## 6. HEDGING

### 6.1 OBJECTIVE AND SCOPE OF HEDGE ACCOUNTING

#### Hedging

means designating one or more hedging instruments so that their change in fair value is an offset, in whole or in part, to the change in fair value or cash flows of a hedged item.

#### A hedged item

is an asset, liability, firm commitment, highly probable forecast transaction or net investment in a foreign operation that:

- (a) exposes the entity to risk of changes in fair value or future cash flows and
- (b) is designated as being hedged.

#### A hedging instrument

is a designated derivative or (for a hedge of the risk of changes in foreign currency exchange rates only) a designated non-derivative financial asset or non-derivative financial liability whose fair value or cash flows are expected to offset changes in the fair value or cash flows of a designated hedged item.

1. 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 net assets/equity, in the case of investments in equity instruments for which an entity has elected to present changes in fair value in net assets/equity in accordance with paragraph 5.8.2(1)). 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.
2. An entity may choose to designate a hedging relationship between a hedging instrument and a hedged item in accordance with paragraphs 6.2 and 6.3. For hedging relationships that meet the qualifying criteria (paragraph 6.4), an entity shall account for the gain or loss on the hedging instrument and the hedged item in accordance with paragraphs 6.5.1–6.5.4. When the hedged item is a group of items, an entity shall comply with the additional requirements in paragraph 6.6.

## 6.2 HEDGING INSTRUMENTS

### 6.2.1 QUALIFYING INSTRUMENTS

1. A derivative 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).
2. 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 net assets/equity in accordance with paragraph 5.8.3(1). 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 net assets/equity in accordance with paragraph 5.8.2(1).
3. 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.

## 6.2.2 DESIGNATION OF HEDGING INSTRUMENTS

1. **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 paragraph 6.5.5);
  - (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 paragraph 6.5.6); and
  - (c) A proportion of the entire hedging instrument, such as 50 percent 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.
2. 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.
3. 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 is a written option 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)). 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 is a written option 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)).

## 6.3 HEDGED ITEMS

### 6.3.1 QUALIFYING ITEMS

1. **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 paragraph 6.6).

A hedged item can also be a component of such an item or group of items (see paragraph 6.3.2).

- 2. The hedged item must be reliably measurable.
- 3. If a hedged item is a forecast transaction (or a component thereof), that transaction must be highly probable.
- 4. An aggregated exposure that is a combination of an exposure that could qualify as a hedged item in accordance with paragraph 1 above and a derivative may be designated as a hedged item. 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.
- 5. 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 Accounting Policy on Consolidated Financial Statements, where transactions between an investment entity and its subsidiaries 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 the Accounting Policy on Consolidated Financial Statements, 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.



6. However, as an exception to paragraph 5 above, 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 the Accounting Policy on The Effects of Changes in Foreign Exchange Rates. 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.

### **6.3.2 DESIGNATION OF HEDGED ITEMS**

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. 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.

## 6.4 QUALIFYING CRITERIA FOR HEDGE ACCOUNTING

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;
  - (ii) The **effect of credit risk does not dominate the value changes** that result from that economic relationship; 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.

## 6.5 ACCOUNTING FOR QUALIFYING HEDGING RELATIONSHIPS

### 6.5.1 GENERAL

1. An entity applies hedge accounting to hedging relationships that meet the qualifying criteria in paragraph 6.4 (which include the entity's decision to designate the hedging relationship).
2. 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 the Accounting Policy on The Effects of Changes in Foreign Exchange Rates.
3. If the hedged item is an equity instrument for which an entity has elected to present changes in fair value in net assets/equity in accordance with paragraph 5.8.2(1), the hedged exposure referred to in paragraph (2)(a) above must be one that could affect net assets/equity. In that case, and only in that case, the recognised hedge ineffectiveness is presented in net assets/equity.
4. 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.
5. If a hedging relationship ceases to meet the hedge effectiveness requirement relating to the hedge ratio (see paragraph 6.4(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 policy as 'rebalancing').
6. 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).

7. An entity shall apply:

- (a) Paragraph 6.5.2(3) 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 6.5.3.(2) when it discontinues hedge accounting for cash flow hedges.

## 6.5.2 FAIR VALUE HEDGES

1. As long as a fair value hedge meets the qualifying criteria in paragraph 6.4, 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 **net assets/equity**, if the hedging instrument hedges an **equity instrument** for which an entity has elected to present changes in fair value in net assets/equity in accordance with paragraph 5.8.2(1)).
  - (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 net assets/equity** in accordance with paragraph 4.1.1(3), 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 net assets/equity** in accordance with paragraph 5.8.2(1), those amounts shall remain in **net assets/equity**. 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.
2. 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.
3. Any adjustment arising from paragraph 1(b) above 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 net assets/equity in accordance with paragraph 4.1.1(3), amortisation applies in the same manner but to the amount that represents the cumulative gain or loss previously recognised in accordance with paragraph 1(b) above instead of by adjusting the carrying amount.

### 6.5.3 CASH FLOW HEDGES

1. As long as a cash flow hedge meets the qualifying criteria in paragraph 6.4, the hedging relationship shall be accounted for as follows:
  - (a) The separate component of equity associated with the hedged item (kept in reserves) 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 item kept in reserves calculated in accordance with (a) above) shall be recognised in net assets/equity.
  - (c) Any remaining gain or loss on the hedging instrument (or any gain or loss required to balance the change in reserves calculated in accordance with (a) above) is hedge ineffectiveness that shall be recognised in surplus or deficit.
  - (d) The amount that has been accumulated in reserves in accordance with (a) above 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 reserves and include it directly in the initial cost or other carrying amount of the asset or the liability. This is not a reclassification adjustment and hence it does not affect net assets/equity.
    - (ii) For cash flow hedges other than those covered by (i) above, that amount shall be reclassified from reserves to surplus or deficit as a reclassification adjustment 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.

2. When an entity discontinues hedge accounting for a cash flow hedge (see paragraphs 6.5.1(6) and 6.5.1(7)(b)) it shall account for the amount that has been accumulated in reserves in accordance with paragraph 1(a) above as follows:
  - (a) If the hedged future cash flows are still expected to occur, that amount shall remain in reserves until the future cash flows occur or until paragraph 1(d)(iii) above applies. When the future cash flows occur, paragraph 1(d) above applies.
  - (b) If the hedged future cash flows are no longer expected to occur, that amount shall be immediately reclassified from reserves to surplus or deficit as a reclassification adjustment. A hedged future cash flow that is no longer highly probable to occur may still be expected to occur.

#### **6.5.4 HEDGES OF A NET INVESTMENT IN A FOREIGN OPERATION**

1. 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 Accounting Policy on The Effects of Changes in Foreign Exchange Rates), 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 net assets/equity (see paragraph 6.5.3(1));  
and
  - (b) The ineffective portion shall be recognised in surplus or deficit.
2. The cumulative gain or loss on the hedging instrument relating to the effective portion of the hedge that has been accumulated in reserves shall be reclassified from net assets/equity to surplus or deficit as a reclassification adjustment in accordance with Accounting Policy on The Effects of Changes in Foreign Exchange Rates on the disposal or partial disposal of the foreign operation.

### **6.5.5 ACCOUNTING FOR THE TIME VALUE OF OPTIONS**

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 6.2.2(1)(a)), it shall account for the time value of the option as follows:

- (a) An entity shall distinguish the time value of options by the type of hedged item that the option hedges:
  - (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 net assets/equity 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 and hence does not affect net assets/equity.
  - (ii) For hedging relationships other than those covered by (i) above, the amount shall be reclassified from the separate component of net assets/equity to surplus or deficit as a reclassification adjustment 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.



(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 net assets/equity 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 net assets/equity, if the hedged item is an equity instrument for which an entity has elected to present changes in fair value in net assets/equity in accordance with paragraph 5.8.2(1)). 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. 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.

#### **6.5.6 ACCOUNTING FOR THE FORWARD ELEMENT OF FORWARD CONTRACTS AND FOREIGN CURRENCY BASIS SPREADS OF FINANCIAL INSTRUMENTS**

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 6.2.2(1)(b)), the entity may apply paragraph 6.5.5 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.

## 6.6 HEDGES OF A GROUP OF ITEMS

### 6.6.1 ELIGIBILITY OF A GROUP OF ITEMS AS THE HEDGED ITEM

A group of items (including a group of items that constitute a net position) 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.

### 6.6.2 DESIGNATION OF A COMPONENT OF A NOMINAL AMOUNT

1. 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.
2. 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.

### **6.6.3 PRESENTATION**

1. 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 surplus or deficit and net assets/equity, 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.
2. 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 6.5.2(1)(b).

### **6.6.4 NIL NET POSITIONS**

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.

## **6.7 OPTION TO DESIGNATE A CREDIT EXPOSURE AS MEASURED AT FAIR VALUE THROUGH SURPLUS OR DEFICIT**

### **6.7.1 ELIGIBILITY OF CREDIT EXPOSURES FOR DESIGNATION AT FAIR VALUE THROUGH SURPLUS OR DEFICIT**

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 accounting policy (for example, an entity may designate loan commitments that are outside the scope of this accounting policy). 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.

## **6.7.2 ACCOUNTING FOR CREDIT EXPOSURES DESIGNATED AT FAIR VALUE THROUGH SURPLUS OR DEFICIT**

1. If a financial instrument is designated in accordance with paragraph 6.7.1 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 net assets/equity in accordance with paragraph 4.1.1(3), the cumulative gain or loss previously recognised in net assets/equity shall immediately be reclassified from net assets/equity to surplus or deficit as a reclassification adjustment.
2. 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 6.7.1 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 4.4(1) was required).
3. 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.

## 7. DISCLOSURES

### 7.1 CLASSES OF FINANCIAL INSTRUMENTS AND LEVEL OF DISCLOSURE

When this accounting policy requires disclosures by class of financial instrument, a public sector entity shall 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. A public sector entity shall provide sufficient information to permit reconciliation to the line items presented in the statement of financial position.

### 7.2 SIGNIFICANCE OF FINANCIAL INSTRUMENTS FOR FINANCIAL POSITION AND FINANCIAL PERFORMANCE

**A public sector entity shall disclose information that enables users of its financial statements to evaluate the significance of financial instruments for its financial position and performance.**

#### 7.2.1 STATEMENT OF FINANCIAL POSITION

##### 7.2.1.1 CATEGORIES OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

The **carrying amounts** of each of the following categories, shall be disclosed either in the statement of financial position or in the notes:

- (a) **Financial assets at fair value through surplus or deficit**, showing separately:
  - (i) those designated as such upon initial recognition or subsequently in accordance with paragraph 6.7.1, and
  - (ii) those mandatorily measured at fair value through surplus or deficit;
- (b) **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 6.7.1, and
  - (ii) those that meet the definition of held for trading;
- (c) **Financial liabilities measured at amortised cost**;
- (d) **Financial assets measured at amortised cost**; and
- (e) **Financial assets measured at fair value through net assets/equity**, showing separately:
  - (i) financial assets that are measured at fair value through net assets/equity in accordance with paragraph 4.1.1(3); and
  - (ii) investments in equity instruments designated as such upon initial recognition in accordance with paragraph 5.8.2(1).

### **7.2.1.2 FINANCIAL ASSETS OR FINANCIAL LIABILITIES AT FAIR VALUE THROUGH SURPLUS OR DEFICIT**

1. If the entity has **designated as measured through surplus or deficit a financial asset** (or group of financial assets) that would otherwise be measured at fair value through net assets/equity or amortised cost, it shall disclose:
  - (a) The maximum exposure to credit risk (see paragraph 7.3.2.1.4(3)(a)) of the financial asset (or group of financial assets) 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 7.3.2.1.4(3)(a)).
  - (c) The amount of change, during the period and cumulatively, in the fair value of the financial asset (or group of financial assets) that is attributable to changes in the credit risk of the financial asset 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; 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 asset.Changes in market conditions that give rise to market risk include changes in an observed (benchmark) interest rate, commodity price, foreign exchange rate, or index of prices or rates.
  - (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 financial asset was designated.
2. If the entity has designated a **financial liability as at fair value through surplus or deficit** in accordance with paragraph 4.2.2 and is required to present the effects of changes on that liability's credit risk in net assets/equity, see paragraph 5.8.3(1), it shall disclose:
  - (a) The amount of change cumulatively in the fair value of the financial liability that is attributable to changes in the credit risk of that liability.
  - (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 net assets/equity that was realised at derecognition.

3. If an entity has designated a **financial liability as at fair value through surplus or deficit** in accordance with paragraph 4.2.2 and 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 5.8.3(1) and (2)), 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; 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.
4. The entity shall also disclose:
  - (a) A detailed description of the methods used to comply with the requirements in paragraphs 1(c) and 2(a) above and 7.2.1.3(3)(a) and 5.8.3(1)(a), 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 paragraphs 1(c) and 2(a) above and 7.2.1.3(3)(a) or 5.8.3(1)(a) 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 net assets/equity would create or enlarge an accounting mismatch in surplus or deficit (see paragraphs 5.8.3(1) and (2)). If an entity is required to present the effects of changes in a liability's credit risk in surplus or deficit (see paragraph 5.8.3(2)), the disclosure must include a detailed description of the economic relationship.

#### **7.2.1.3 INVESTMENTS IN EQUITY INSTRUMENTS DESIGNATED AT FAIR VALUE THROUGH NET ASSETS/EQUITY**

- 1 If an entity has designated investments in equity instruments to be measured at fair value through net assets/equity, as permitted by paragraph 5.8.2(1), it shall disclose:
  - (a) Which investments in equity instruments have been designated to be measured at fair value through net assets/equity.
  - (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.



2. If an entity derecognised investments in equity instruments measured at fair value through net assets/equity 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.

#### **7.2.1.4 RECLASSIFICATION**

1. An entity shall disclose if, in the current or previous reporting periods, it has reclassified any financial assets in accordance with paragraph 4.4(1). 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.
2. 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 net assets/equity in accordance with paragraph 4.4(1):
  - (a) The effective interest rate determined on the date of reclassification; and
  - (b) The interest revenue recognised.
3. If, since its last reporting date, an entity has reclassified financial assets out of the fair value through net assets/equity 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 net assets/equity 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 net assets/equity during the reporting period if the financial assets had not been reclassified.

### **7.2.1.5 OFFSETTING FINANCIAL ASSETS AND FINANCIAL LIABILITIES**

1. The disclosures in paragraphs 2 – 5 below supplement the other disclosure requirements of this policy and are required for all recognised financial instruments that are set off in accordance with paragraph 2.5. 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 2.5.
2. 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 1 above.
3. To meet the objective in paragraph 2 above, 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 1 above:
  - (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 2.5 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 (b) above, including:
    - (i) Amounts related to recognised financial instruments that do not meet some or all of the offsetting criteria in paragraph 2.5; and
    - (ii) Amounts related to financial collateral (including cash collateral); and
  - (e) The net amount after deducting the amounts in paragraph (d) from the amounts in paragraph (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.
4. The total amount disclosed in accordance with paragraph 3(d) above for an instrument shall be limited to the amount in paragraph 3(c) above for that instrument.
5. 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 3(d) above, including the nature of those rights.
6. If the information required by paragraphs 2-5 above is disclosed in more than one note to the financial statements, an entity shall cross-refer between those notes.

#### **7.2.1.6 COLLATERAL**

1. 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 3.2.5(2)(a); and
  - (b) The terms and conditions relating to its pledge.
2. When an entity holds collateral (of financial or non-financial assets) and is permitted to sell or repledge the collateral in the absence of default by the owner of the collateral, it shall disclose:
  - (a) The fair value of the collateral held;
  - (b) The fair value of any such collateral sold or repledged, and whether the entity has an obligation to return it; and
  - (c) The terms and conditions associated with its use of the collateral.

#### **7.2.1.7 ALLOWANCE ACCOUNT FOR CREDIT LOSSES**

The carrying amount of financial assets measured at fair value through net assets/equity in accordance with paragraph 4.1.1(3) is 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.

#### **7.2.1.8 COMPOUND FINANCIAL INSTRUMENTS WITH MULTIPLE EMBEDDED DERIVATIVES**

If an entity has issued an instrument that contains both a liability and an equity component (see paragraph 2.2) and the instrument has multiple embedded derivatives whose values are interdependent (such as a callable convertible debt instrument), it shall disclose the existence of those features.

#### **7.2.1.9 DEFAULTS AND BREACHES**

1. For loans payable recognised at the end of the reporting period, an entity shall disclose:
  - (a) Details of any defaults during the period of principal, interest, sinking fund, or redemption terms of those loans payable;
  - (b) The carrying amount of the loans payable in default at the end of the reporting period; and
  - (c) Whether the default was remedied, or the terms of the loans payable were renegotiated, before the financial statements were authorised for issue.
2. If, during the period, there were breaches of loan agreement terms other than those described in paragraph 1 above, an entity shall disclose the same information as required by paragraph 1 above if those breaches permitted the lender to demand accelerated repayment (unless the breaches were remedied, or the terms of the loan were renegotiated, on or before the end of the reporting period).

## 7.2.2 STATEMENT OF FINANCIAL PERFORMANCE

### 7.2.2.1 ITEMS OF REVENUE, EXPENSE, GAINS, OR LOSSES

1. An entity shall disclose the following items of revenue, expense, gains, or losses either in the statement of financial performance or in the notes:
  - (a) Net gains or net losses on:
    - (i) Financial assets or financial liabilities 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 6.7.1, and those on financial assets or financial liabilities that are mandatorily measured at fair value through surplus or deficit (e.g. financial liabilities that meet the definition of held for trading). 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 net assets/equity and the amount recognised in surplus or deficit;
    - (ii) Financial liabilities measured at amortised cost;
    - (iii) Financial assets measured at amortised cost;
    - (iv) Investments in equity instruments designated at fair value through net assets/equity in accordance with paragraph 5.8.2(1); and
    - (v) Financial assets measured at fair value through net assets/equity in accordance with paragraph 4.1.1(3), showing separately the amount of gain or loss recognised in net assets/equity during the period and the amount reclassified upon derecognition from accumulated net assets/equity to surplus or deficit for the period.
  - (b) Total interest revenue and total interest expense (calculated using the effective interest method) for financial assets or financial liabilities that are measured at amortised cost or that are measured at fair value through net assets/equity in accordance with paragraph 4.1.1(3) (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.
2. An entity shall disclose an analysis of the gain or loss recognised in the statement of financial performance 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.

## **7.2.3 OTHER DISCLOSURES**

### **7.2.3.1 ACCOUNTING POLICIES**

In accordance with the Accounting Policy on Presentation of Financial Statements, an entity discloses, in the summary of significant accounting policies, 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.

### **7.2.3.2 HEDGE ACCOUNTING**

1. An entity shall apply the disclosure requirements in paragraphs 7.2.3.2(2) – 7.2.3.5(6) 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 financial performance and statement of changes in net assets/equity.
2. 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.
3. When paragraphs 7.2.3.3 - 7.2.3.5 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.
4. To meet the objectives in paragraph 1 above, 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 policy.

### **7.2.3.3 THE RISK MANAGEMENT STRATEGY**

1. 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.
2. To meet the requirements in paragraph 1 above, 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.
3. When an entity designates a specific risk component as a hedged item (see paragraph 6.3.2) it shall provide, in addition to the disclosures required by paragraphs 1 and 2 above, 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).

### **7.2.3.4 THE AMOUNT, TIMING AND UNCERTAINTY OF FUTURE CASH FLOWS**

1. Unless exempted by paragraph 3 below, 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.
2. To meet the requirement in paragraph 1 above, 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.

3. 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) the entity:
  - (a) Is exempt from providing the disclosures required by paragraphs 1 and 2 above.
  - (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.
4. 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.
5. 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.
6. 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.

### **7.2.3.5 THE EFFECTS OF HEDGE ACCOUNTING ON FINANCIAL POSITION AND PERFORMANCE**

1. 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 meters) of the hedging instruments.
  
2. 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 6.5.2(3).
  - (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 6.5.3(1)(c));
    - (ii) The balances in reserves for continuing hedges that are accounted for in accordance with paragraphs 6.5.3(1) and 6.5.4(1)(a); and
    - (iii) The balances remaining in reserves from any hedging relationships for which hedge accounting is no longer applied.



3. 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 net assets/equity for hedges of an equity instrument for which an entity has elected to present changes in fair value in net assets/equity in accordance with paragraph 5.8.2(1)); and
    - (ii) The line item in the statement of financial performance 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 net assets/equity;
    - (ii) Hedge ineffectiveness recognised in surplus or deficit;
    - (iii) The line item in the statement of financial performance that includes the recognised hedge ineffectiveness;
    - (iv) The amount reclassified from reserves into surplus or deficit as a reclassification adjustment (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 financial performance that includes the reclassification adjustment; and
    - (vi) For hedges of net positions, the hedging gains or losses recognised in a separate line item in the statement of financial performance (see paragraph 6.6.3(1)).
4. When the volume of hedging relationships to which the exemption in paragraph 7.2.3.4(3) 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.
5. An entity shall provide a reconciliation of each component of net assets/equity and an analysis of net assets/equity in accordance with Accounting Policy on Presentation of Financial Statements that, taken together:
  - (a) Differentiates, at a minimum, between the amounts that relate to the disclosures in paragraph 3(b)(i) and (iv) above as well as the amounts accounted for in accordance with paragraph 6.5.5(b)(i) and (iii);

- (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 6.5.5; 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 6.5.6.
6. An entity shall disclose the information required in paragraph 5 above separately by risk category. This disaggregation by risk may be provided in the notes to the financial statements.

**7.2.3.6 OPTION TO DESIGNATE A CREDIT EXPOSURE AS MEASURED AT FAIR VALUE THROUGH SURPLUS OR DEFICIT**

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 6.7.1, 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 6.7.1; 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 6.7.2(3) and the related nominal or principal amount (except for providing comparative information in accordance with the Accounting Policy on Presentation of Financial Statements, an entity does not need to continue this disclosure in subsequent periods).

### 7.2.3.7 FAIR VALUE

- 1 Except as set out in paragraph 7 below for each class of financial assets and financial liabilities (see paragraph 7.1), an entity shall disclose the fair value of that class of assets and liabilities in a way that permits it to be compared with its carrying amount.
2. In disclosing fair values, an entity shall group financial assets and financial liabilities into classes, but shall offset them only to the extent that their carrying amounts are offset in the statement of financial position.
3. An entity shall disclose for each class of financial instruments the methods and, when a valuation technique is used, the assumptions applied in determining fair values of each class of financial assets or financial liabilities. For example, if applicable, an entity discloses information about the assumptions relating to prepayment rates, rates of estimated credit losses, and interest rates or discount rates. If there has been a change in valuation technique, the entity shall disclose that change and the reasons for making it.
4. To make the disclosures required by paragraph 5 below an entity shall classify fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy shall have the following levels:
  - (a) Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1);
  - (b) Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as price) or indirectly (i.e. derived from prices) (Level 2); and
  - (c) Inputs for the asset or liability that are not based on observable market data (unobservable inputs) (Level 3).

The level in the fair value hierarchy within which the fair value measurement is categorised in its entirety shall be determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. For this purpose, the significance of an input is assessed against the fair value measurement in its entirety. If a fair value measurement uses observable inputs that require significant adjustments based on unobservable inputs, that measurement is a Level 3 measurement. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgment, considering factors specific to the asset or liability.

5. For fair value measurements recognised in the statement of financial position an entity shall disclose for each class of financial instruments:
- (a) The level in the fair value hierarchy into which the fair value measurements are categorised in their entirety, segregating fair value measurements in accordance with the levels defined in paragraph 4 above.
  - (b) Any significant transfers between Level 1 and Level 2 of the fair value hierarchy and the reasons for those transfers. Transfers into each level shall be disclosed and discussed separately from transfers out of each level. For this purpose, significance shall be judged with respect to surplus or deficit, and total assets or total liabilities.
  - (c) For fair value measurements in Level 3, a reconciliation from the opening balances to the closing balances, disclosing separately changes during the period attributable to the following:
    - (i) Total gains or losses for the period recognised in surplus or deficit, and a description of where they are presented in the statement of financial performance;
    - (ii) Total gains or losses recognised in net assets/equity;
    - (iii) Purchases, sales, issues, and settlements (each type of movement disclosed separately); and
    - (iv) Transfers into or out of Level 3 (e.g. transfers attributable to changes in the observability of market data) and the reasons for those transfers. For significant transfers, transfers into Level 3 shall be disclosed and discussed separately from transfers out of Level 3.
  - (d) The amount of total gains or losses for the period in (c)(i) above included in surplus or deficit that are attributable to gains or losses relating to those assets and liabilities held at the end of the reporting period and a description of where those gains or losses are presented in the statement of financial performance.
  - (e) For fair value measurements in Level 3, if changing one or more of the inputs to reasonably possible alternative assumptions would change fair value significantly, the entity shall state that fact and disclose the effect of those changes. The entity shall disclose how the effect of a change to a reasonably possible alternative assumption was calculated. For this purpose, significance shall be judged with respect to surplus or deficit, and total assets or total liabilities, or, when changes in fair value are recognised in net assets/equity, total equity.

An entity shall present the quantitative disclosures required by this paragraph in tabular format unless another format is more appropriate.

6. If the market for a financial instrument is not active, an entity establishes its fair value using a valuation technique. 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). 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; 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.
7. 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) For a contract containing a discretionary participation feature if the fair value of that feature cannot be measured reliably.
8. In the case described in paragraph 7(b) above, an entity shall disclose information to help users of the financial statements make their own judgments about the extent of possible differences between the carrying amount of those contracts and their fair value, including:
  - (a) The fact that fair value information has not been disclosed for these instruments because their fair value cannot be measured reliably;
  - (b) A description of the financial instruments, their carrying amount, and an explanation of why fair value cannot be measured reliably;
  - (c) Information about the market for the instruments;
  - (d) Information about whether and how the entity intends to dispose of the financial instruments; and
  - (e) If financial instruments whose fair value previously could not be reliably measured are derecognised, that fact, their carrying amount at the time of derecognition, and the amount of gain or loss recognised.

### 7.2.3.8 CONCESSIONARY LOANS

1. 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 4.1.1(2), 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) Impairment losses recognised;
    - (v) Any increase during the period in the discounted amount arising from the passage of time; 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; and
  - (d) Valuation assumptions.
2. For concessionary loans measured at fair value in accordance with paragraph 4.1.1(3) or 4.1.1(5) 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
    - (v) 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; and
  - (d) Valuation assumptions.

## **7.3 NATURE AND EXTENT OF RISKS ARISING FROM FINANCIAL INSTRUMENTS**

1. An entity shall disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period.
2. The disclosures required by paragraphs 7.3.1 – 7.3.2 focus on the risks that arise from financial instruments and how they have been managed. These risks typically include, but are not limited to, credit risk, liquidity risk, and market risk.
3. 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.

### **7.3.1 QUALITATIVE DISCLOSURES**

For each type of risk arising from financial instruments, an entity shall disclose:

- (a) The exposures to risk and how they arise;
- (b) Its objectives, policies, and processes for managing the risk and the methods used to measure the risk; and
- (c) Any changes in (a) or (b) from the previous period.

### **7.3.2 QUANTITATIVE DISCLOSURES**

1. 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 the Accounting Policy on Related Party Disclosures), for example, the entity's governing body or chief executive officer.
  - (b) The disclosures required by paragraphs 7.3.2.1.4(3)-7.3.2.3.2, to the extent not provided in accordance with (a) above.
  - (c) Concentrations of risk if not apparent from the disclosures in accordance with (a) and (b) above.

2. If the quantitative data disclosed as at the end of the reporting period are unrepresentative of an entity's exposure to risk during the period, an entity shall provide further information that is representative.

### **7.3.2.1 CREDIT RISK**

#### **7.3.2.1.1 SCOPE AND OBJECTIVES**

1. An entity shall apply the disclosure requirements in paragraphs 7.3.2.1.2 – 7.3.2.1.4(2) to financial instruments to which the impairment requirements are applied. However:
  - (a) For receivables that result from exchange transactions that are within the scope of the Accounting Policy on Revenue from Exchange Transactions and non-exchange transactions within the scope of the Accounting Policy on Revenue from Non-Exchange Transactions (Taxes and Transfers) and lease receivables, paragraph 7.3.2.1.3(3) applies to those receivables or lease receivables on which lifetime expected credit losses are recognised in accordance with paragraph 5.6.2(1), if those financial assets are modified while more than 30 days past due; and
  - (b) Paragraph 7.3.2.1.3(4) does not apply to lease receivables.
2. The credit risk disclosures made in accordance with paragraphs 7.3.2.1.2 - 7.3.2.1.4(2) 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.
3. 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.



4. To meet the objectives in paragraph 2 above, 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.
5. If the disclosures provided in accordance with paragraphs 7.3.2.1.2 - 7.3.2.1.4(2) are insufficient to meet the objectives in paragraph 2, an entity shall disclose additional information that is necessary to meet those objectives.

#### **7.3.2.1.2 THE CREDIT RISK MANAGEMENT PRACTICES**

1. 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 5.6.1.2(2), including the classes of financial instruments to which it applies; and
    - (ii) The presumption in paragraph 5.6.1.2(3), 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 5.6.1.3 for 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 5.6.1.1(5); 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 5.6.1.1(3).

2. An entity shall explain the inputs, assumptions and estimation techniques used to apply the requirements in paragraph 5.6. 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.

#### **7.3.2.1.3 QUANTITATIVE AND QUALITATIVE INFORMATION ABOUT AMOUNTS ARISING FROM EXPECTED CREDIT LOSSES**

1. 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 the Accounting Policy on Revenue from Exchange Transactions or non-exchange transactions that are within the scope of the Accounting Policy on Revenue from Non-Exchange Transactions (Taxes and Transfers) or lease receivables for which the loss allowances are measured in accordance with paragraph 5.6.2(1).
  - (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.

2. To enable users of financial statements to understand the changes in the loss allowance disclosed in accordance with paragraph 1 above, 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 1(a) - (c) above 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;
  - (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.
3. 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.
4. 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).
  - (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.
5. 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.

#### **7.3.2.1.4 CREDIT RISK EXPOSURE**

- 1 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 the Accounting Policy on Revenue from Exchange Transactions or non-exchange transactions that are within the scope of the Accounting Policy on Revenue from Non-Exchange Transactions (Taxes and Transfers) or lease receivables for which the loss allowances are measured in accordance with paragraph 5.6.2(1).
  - (c) That are purchased or originated credit-impaired financial assets.
2. For receivables that result from exchange transactions that are within the scope of Accounting Policy on Revenue from Exchange Transactions or non-exchange transactions that are within the scope of the Accounting Policy on Revenue from Non-Exchange Transactions (Taxes and Transfers) receivables to which an entity applies paragraph 5.6.2(1), the information provided in accordance with paragraph 1 above may be based on a provision matrix.

3. For all financial instruments within the scope of this accounting policy, but to which the impairment requirements are 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); this disclosure is not required for financial instruments whose carrying amount best represents the maximum exposure to credit risk;
- (b) 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);

#### **7.3.2.1.5 COLLATERAL AND OTHER CREDIT ENHANCEMENTS OBTAINED**

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 policies, an entity shall disclose for such assets held at the reporting date:

- (a) The nature and carrying amount of the assets; 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.

#### **7.3.2.2 LIQUIDITY RISK**

An entity shall disclose:

- (a) A maturity analysis for non-derivative financial liabilities (including issued financial guarantee contracts) that shows the remaining contractual maturities.
- (b) A maturity analysis for derivative financial liabilities. The maturity analysis shall include the remaining contractual maturities for those derivative financial liabilities for which contractual maturities are essential for an understanding of the timing of the cash flows.
- (c) A description of how it manages the liquidity risk inherent in (a) and (b).

#### **7.3.2.3 MARKET RISK**

##### **7.3.2.3.1 SENSITIVITY ANALYSIS**

- 1. Unless an entity complies with paragraph 2 below, it shall disclose:
  - (a) A sensitivity analysis for each type of market risk to which the entity is exposed at the end of the reporting period, showing how surplus or deficit and net assets/equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date;
  - (b) The methods and assumptions used in preparing the sensitivity analysis; and

- (c) Changes from the previous period in the methods and assumptions used, and the reasons for such changes.
- 2. If an entity prepares a sensitivity analysis, such as value-at-risk, that reflects interdependencies between risk variables (e.g. interest rates and exchange rates) and uses it to manage financial risks, it may use that sensitivity analysis in place of the analysis specified in paragraph 1 above. The entity shall also disclose:
  - (a) An explanation of the method used in preparing such a sensitivity analysis, and of the main parameters and assumptions underlying the data provided; and
  - (b) An explanation of the objective of the method used and of limitations that may result in the information not fully reflecting the fair value of the assets and liabilities involved.

#### **7.3.2.3.2 OTHER MARKET RISK DISCLOSURES**

When the sensitivity analyses disclosed in accordance with paragraph 7.3.2.3.1 are unrepresentative of a risk inherent in a financial instrument (e.g. because the year-end exposure does not reflect the exposure during the year), the entity shall disclose that fact and the reason it believes the sensitivity analyses are unrepresentative.

## **7.4 TRANSFERS OF FINANCIAL ASSETS**

### **7.4.1 GENERAL**

1. The disclosure requirements in the current section (7.4) relating to transfers of financial assets supplement the other disclosure requirements of this accounting policy. An entity shall present the disclosures required by this section 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 this section, 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.
2. 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.

3. For the purposes of applying the disclosure requirements in paragraphs 7.4.3 – 7.4.4, 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. 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 paragraphs 3.2.1(5)(a) - (c) are met.

#### **7.4.2 TRANSFERRED FINANCIAL ASSETS THAT ARE NOT DERECOGNISED IN THEIR ENTIRETY**

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 objective set out in paragraph 7.4.1(2)(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 3.2.1(6)(c)(ii) and 3.2.4(1), 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.

### **7.4.3 TRANSFERRED FINANCIAL ASSETS THAT ARE DERECOGNISED IN THEIR ENTIRETY**

1. To meet the objective set out in paragraph 7.4.1(2)(b), when an entity derecognises transferred financial assets in their entirety (see paragraph 3.2.1(6)(a) and (c)(i) 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) above.
2. An entity may aggregate the information required by paragraph 1 above 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.
3. 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 net assets/equity is presented.

#### **7.4.4 SUPPLEMENTARY INFORMATION**

An entity shall disclose any additional information that it considers necessary to meet the disclosure objectives in paragraph 7.4.1(2).

## **8. TRANSITIONAL PROVISIONS**

### **8.1 DESIGNATION OF FINANCIAL INSTRUMENTS ON THE DATE OF ADOPTION OF IPSASs**

- 1 A first-time adopter may designate a financial asset or financial liability as a financial asset or financial liability at fair value through surplus or deficit that meet the criteria for designation as such, in accordance with paragraph 2 below. A first-time adopter shall disclose the fair value of financial assets and financial liabilities designated into each category at the date of designation, their classification and carrying amount.
2. This accounting policy permits a financial asset to be designated on initial recognition as a financial instrument (provide it meets certain criteria) to be designated as a financial asset or financial liability at fair value through surplus or deficit. Despite this requirement, a first-time adopter is permitted to designate, at the date of adoption of IPSASs, any financial asset or financial liability as at fair value through surplus or deficit provided the asset or liability meets the criteria in paragraphs 4.1.2, 4.2.2(a) or 4.2.2(b) at that date.
3. An entity may designate an investment in an equity instrument as at fair value through net assets/equity in accordance with paragraph 5.8.2(1) on the basis of the facts and circumstances that exist at the date of adoption of IPSASs.

### **8.2 DERECOGNITION OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES**

1. Except as permitted by paragraph 2 below a first-time adopter shall apply the derecognition requirements in this accounting policy prospectively for transactions occurring on or after the date of adoption of IPSASs.
2. Notwithstanding the provision in paragraph 1 above, a first-time adopter may apply the derecognition requirements in this accounting policy retrospectively from a date of the first-time adopter choosing, provided that the information needed to apply this accounting policy to financial assets and financial liabilities derecognised as a result of past transactions was obtained at the time of initially accounting for these transactions.

## **8.3 CLASSIFICATION AND MEASUREMENT OF FINANCIAL INSTRUMENTS**

1. An entity shall assess whether a financial asset meets the conditions in paragraph 4.1.1(2) or the conditions in paragraph 4.1.1(3) on the basis of the facts and circumstances that exist at the date of adoption of IPSASs.
2. If it is impracticable to assess a modified time value of money element on the basis of the facts and circumstances that exist at the date of transition to IPSASs, 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 adoption of IPSASs without taking into account the requirements related to the modification of the time value of money element.
3. If it is impracticable to assess whether the fair value of a prepayment feature is insignificant on the basis of the facts and circumstances that exist at the date of adoption of IPSASs, 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 adoption of IPSASs without taking into account the exception for prepayment features.
4. If it is impracticable (as defined in the Accounting Policy on Accounting Policies, Changes in Accounting Estimates and Errors) for an entity to apply retrospectively the effective interest method in this accounting policy, the fair value of the financial asset or the financial liability at the date of adoption of IPSASs shall be the new gross carrying amount of that financial asset or the new amortised cost of that financial liability at the date of adoption of IPSASs.

## **8.4 IMPAIRMENT OF FINANCIAL ASSETS**

1. A first-time adopter shall apply the impairment requirements prospectively from the date of adoption of IPSASs.
2. A first-time adopter shall on the date of adoption of IPSASs, assess whether there is any indication that the financial instrument recognised and/or measured in the statement of financial position, is impaired. Any impairment loss incurred shall be recognised in opening accumulated surplus or deficit in the period in which the financial instrument is recognised and/or measured.
3. A first-time adopter shall apply the impairment requirements prospectively. This means that on the date of adoption of this accounting policy, a first-time adopter shall be required to assess whether there is an indication that the financial instrument is impaired. Any impairment loss shall be recognised in opening accumulated surplus or deficit on the date of adoption of IPSASs.

4. At the date of adoption of this accounting policy, a first-time adopter 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 5.6.1.1(6)) and compare that to the credit risk at the date of adoption of IPSASs.
5. When determining whether there has been a significant increase in credit risk since initial recognition, an entity may apply:
  - (a) The requirements in paragraph 5.6.1.2(2); and
  - (b) The rebuttable presumption in paragraph 5.6.1.2(3) 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.
6. If, at the date of adoption of IPSASs, 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 5 above applies).

## **8.5 EMBEDDED DERIVATIVES**

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.

## **8.6 DISCLOSURES**

A first-time adopter shall apply the disclosure requirements prospectively from the date of adoption of IPSASs.

## **9. EFFECTIVE DATE**

The rules mentioned above shall be effective for annual financial statement covering periods beginning on or after 1 January 2020.

## 10. REFERENCES

This accounting policy is based on the following standards:

IPSAS 28 Financial Instruments: Presentation;

Exposure Draft 62 Financial Instruments;

IPSAS 30 Financial Instruments: Disclosures; and

IPSAS 33 First time adoption of accrual basis IPSAS.