# PBE IPSAS 29: FINANCIAL INSTRUMENTS - RECOGNITION AND MEASUREMENT (1)

Version 1: 2014

**Effective Periods Beginning**
1 April 2015

## INITIAL RECOGNITION

Financial instruments are recognised on the Statement of Financial Position when the entity becomes party to the contractual provisions of the instrument.

## INITIAL MEASUREMENT

All financial instruments are measured initially at fair value, directly attributable transaction costs are added to or deducted from the carrying value of those financial instruments that are not measured at fair value through surplus or deficit.

- **Fair value -** is defined in terms of a price agreed by a willing buyer and a willing seller in an arm's length transaction.
- **Directly attributable transaction costs** - incremental cost that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability.

## SUBSEQUENT MEASUREMENT

Subsequent measurement depends on the category into which the financial instrument is classified.

### FINANCIAL ASSETS

#### Fair Value through Surplus or Deficit

Includes financial assets held for trading; derivatives, unless accounted for as hedges, and other financial assets designated to this category under the fair value option (strict rules apply).

- E.g. shares held for trading, FEC's, options, interest rate swaps.

**Measured at:**

- Fair value with all gains and losses being recognised in surplus or deficit.

#### Held-to-Maturity

Non-derivative financial assets with fixed or determinable payments and fixed maturity that the entity has the positive intent and ability to hold to maturity.

- E.g. bonds, redeemable debentures, redeemable preference shares.

**Measured at:**

- Amortised cost using the effective interest method, less impairment losses.

#### Loans and Receivables

Non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

- E.g. trade receivables, long-term bank deposits, intercompany loans receivable.

**Measured at:**

- Amortised cost using the effective interest method, less impairment losses.

#### Available-for-Sale

Includes all financial assets that are not classified in another category and any financial asset designated to this category on initial recognition.

- E.g. shares held for investment purposes.

**Measured at:**

- Fair value with gains and losses recognised in other comprehensive revenue and expense
- Impairment losses and foreign exchange differences are recognised in surplus or deficit.

### FINANCIAL LIABILITIES

#### Fair Value through Surplus or Deficit

Includes financial liabilities held for trading; derivatives; and financial liabilities designated as at fair value through surplus or deficit on initial recognition (strict rules apply).

**Measured at:**

- Fair value with all gains and losses being recognised in surplus or deficit.

#### Amortised Cost

All financial liabilities that are not classified at fair value through surplus or deficit.

**Measured at:**

- Amortised cost using the effective interest method,

## TIER 2 NZ IFRS RDR REPORTERS

RDR Reporters are required to comply with PBE IPSAS 29 in full.

# PBE IPSAS 29: FINANCIAL INSTRUMENTS - RECOGNITION AND MEASUREMENT (2)

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## FINANCIAL GUARANTEE CONTRACTS

**Financial Guarantee Contract** – 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.

## MEASUREMENT

- Initially measured at fair value plus directly attributable transaction costs.
- Subsequently measured at the higher of:
  - The amount determined in accordance with PBE IPSAS 19 – *Provisions, Contingent Liabilities and Contingent Assets*; and
  - The amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with PBE IPSAS 9 – *Revenue from Exchange Transactions*.

## IMPAIRMENT

Assess at each reporting date whether there is objective evidence that a financial asset (group of financial assets) is impaired. If there is evidence of impairment:

**Financial assets at amortised cost**

- Amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted using the asset's original effective interest rate. Future credit losses that have not been incurred are excluded.
- The carrying amount of the asset is reduced either directly or through the use of an allowance account.
- The impairment loss is recognised in surplus or deficit.
- Reversals of impairment are recognised in surplus or deficit. Reversals cannot result in a carrying amount that exceeds what the amortised cost would have been had no impairment been recognised.

**Financial assets at cost**

- Amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

**Available for sale financial assets**

- When a decline in the fair value of the asset has been recognised directly in other comprehensive revenue and expense and there is objective evidence that the asset is impaired, the cumulative loss recognised directly in other comprehensive revenue and expense is removed from net assets/equity and recognised in surplus or deficit.
- Impairment losses recognised in surplus or deficit on equity instruments are not reversed through surplus or deficit.
- Impairment losses recognised in surplus or deficit on debt instruments are reversed through surplus or deficit.

## RECLASSIFICATION

**Financial instruments at fair value through surplus or deficit:**

- Derivative financial instruments may not be reclassified out of this category while it is held or issued.
- Any financial instrument designated into this category on initial recognition may not be reclassified out of this category.
- May reclassify instruments that would have met the definition of loans and receivables out of this category to loans and receivables if the entity has the intention and ability to hold for the foreseeable future or until maturity. Any gain or loss already recognised in surplus or deficit is not reversed. The fair value on date of reclassification becomes the new cost or amortised cost.
- May not reclassify a financial instrument into the fair value through surplus or deficit category after initial recognition.

**Held to maturity instruments:**

- If no longer appropriate to classify investment as held to maturity, reclassify as available for sale and remeasure to fair value.
- Difference between carrying amount and fair value recognised in other comprehensive revenue and expense.
- Prohibited from classifying any instrument as HTM in the current and following two financial years.

**Available for sale instruments:**

- May reclassify instruments that would have met the definition of loans and receivables out of this category to loans and receivables if the entity has the intention and ability to hold for the foreseeable future or until maturity.

**Financial instruments measured at cost as unable to reliably measure fair value:**

- If a reliable measure becomes available for which a fair value measure was previously not available, the instrument is required to be measured at fair value.
- Difference between carrying amount and fair value recognised in equity for available for sale instruments.
- Difference between carrying amount and fair value recognised in surplus or deficit for financial instruments measured at fair value through surplus or deficit.

**Fair value measurement is no longer reliably measureable:**

- If a financial instrument currently carried at fair value subsequently has to be carried at cost or amortised cost, because fair value is no longer reliably measurable, the fair value carrying amount at that date becomes the new cost or deemed cost.
- Prior gain/loss on financial asset with no fixed maturity recognised in net assets/equity remains in net assets/equity until the financial asset is derecognised at which time it is released to surplus or deficit.

## CONCESSIONARY LOANS

- Are loans granted to or received at below market terms.
- Distinguishable from waiver of debt owing by or to an entity.
- Transaction price on initial recognition is not at fair value.
- For all concessionary loans, the day 1 fair value must be calculated.
- Resultant gain/loss recognised as follows:
  - Loans received by entity : gain is accounted for in accordance with PBE IPSAS 23 – *Revenue from Non-Exchange Transactions*.
  - Loans granted by entity: expense is recognised in surplus or deficit or as an additional investment in a controlled entity if granted by the controlling entity.
- Subsequent measurement is dependent on what category it is classified as.

# PBE IPSAS 29: FINANCIAL INSTRUMENTS - RECOGNITION AND MEASUREMENT (3)

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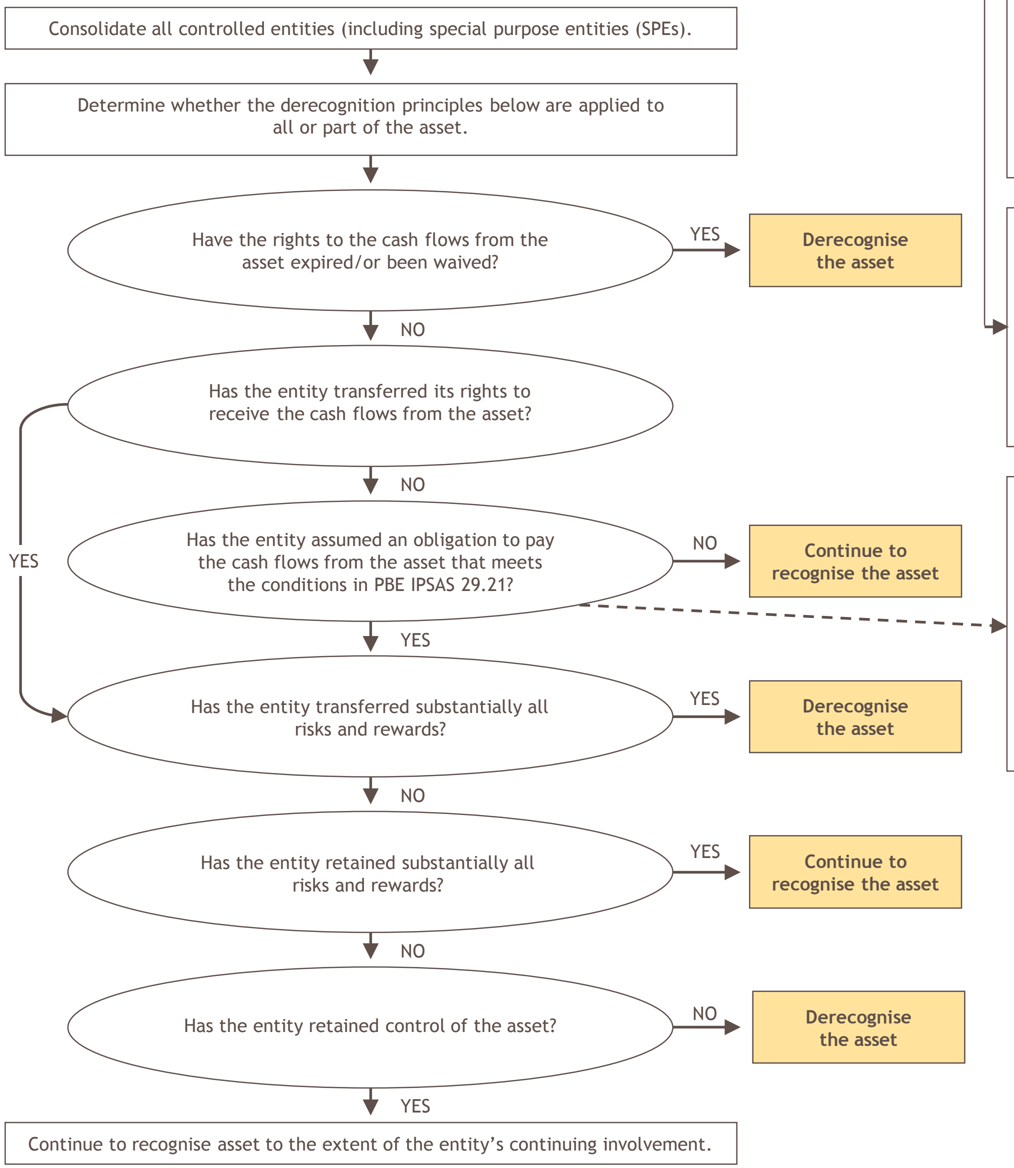
## DERECOGNITION

### FINANCIAL ASSETS



Consolidate all controlled entities (including special purpose entities (SPEs).

Determine whether the derecognition principles below are applied to all or part of the asset.

Have the rights to the cash flows from the asset expired/or been waived?

YES → **Derecognise the asset**

NO

Has the entity transferred its rights to receive the cash flows from the asset?

YES

NO

Has the entity assumed an obligation to pay the cash flows from the asset that meets the conditions in PBE IPSAS 29.21?

NO → **Continue to recognise the asset**

YES

Has the entity transferred substantially all risks and rewards?

YES → **Derecognise the asset**

NO

Has the entity retained substantially all risks and rewards?

YES → **Continue to recognise the asset**

NO

Has the entity retained control of the asset?

NO → **Derecognise the asset**

YES

Continue to recognise asset to the extent of the entity's continuing involvement.

### FINANCIAL LIABILITIES

- A financial liability is derecognised only when extinguished – i.e., when the obligation specified in the contract is discharged, cancelled or it expires.
- An exchange between an existing borrower and lender of debt instruments with substantially different terms or substantial modification of the terms of an existing financial liability of part thereof is accounted for as an extinguishment.
- The difference between the carrying amount of a financial liability extinguished or transferred to a 3rd party and the consideration paid is recognised in surplus or deficit.

- 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 recognises either a servicing asset or liability for that servicing contract.
- If, as a result of a transfer, a financial asset is derecognised, but the entity obtains a new financial asset or assumes a new financial liability or servicing liability, the entity recognises the new financial asset, financial liability or servicing liability at fair value.
- On derecognition of a financial asset, the difference between the carrying amount and the sum of (i) the consideration received and (ii) any cumulative gain or loss that was recognised directly in equity is recognised in surplus or deficit.

PBE IPSAS 29.21 – where an entity retains the contractual rights to receive the cash flows of a financial asset, but assumes a contractual obligation to pay those cash flows to one or more entities – has three conditions that need to be met before an entity can derecognise a financial asset, namely:

- The entity has no obligation to pay amounts to the eventual recipients unless it collects equivalent amounts from the original asset.
- 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.
- The entity has an obligation to remit any cash flows it collects on behalf of the eventual recipients without material delay. The entity is not entitled to reinvest the cash flows except for the short period between collection and remittance to the eventual recipients. Any interest earned thereon is remitted to the eventual recipients.

# PBE IPSAS 29: FINANCIAL INSTRUMENTS - RECOGNITION AND MEASUREMENT (4)

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## HEDGING

Hedge accounting may be applied, if and only if, **all** the following criteria are met:

- At the inception of the hedge there is formal designation and documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge.
- The hedge is expected to be highly effective (80% – 125% effective) in achieving offsetting changes in fair value or cash flows attributable to the hedged risk, consistently with the originally documented risk management strategy for that particular hedging relationship.
- For cash flow hedges, a forecast transaction that is the subject of the hedge must be highly probable and must present an exposure to variations in cash flows that could ultimately affect surplus or deficit.
- The effectiveness of the hedge can be reliably measured, i.e., the fair value or cash flows of the hedged item that are attributable to the hedged risk and the fair value of the hedging instrument can be reliably measured.
- The hedge is assessed on an ongoing basis and determined actually to have been highly effective throughout the financial reporting periods for which the hedge was designated.

## CASH FLOW HEDGE

- **Definition** - a hedge of the exposure to variability in cash flows that (i) is attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction and (ii) could affect surplus or deficit.
- The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised in other comprehensive revenue and expense; and the ineffective portion of the gain or loss on the hedging instrument is recognised in surplus or deficit.
- If the hedge results in the recognition of a financial asset or a financial liability, the associated gains or losses that were recognised in other comprehensive revenue and expense are reclassified from net assets/equity to surplus or deficit as a reclassification adjustment in the same period(s) during which the asset acquired or liability assumed affects surplus or deficit.
- If the hedge results in the recognition of a non-financial asset or a non-financial liability, then the entity has an accounting policy election of either:
  - Reclassifying the associated gains and losses that were recognised in net assets/equity to surplus or deficit as a reclassification adjustment in the same period or periods during which the asset acquired or liability assumed affects profit or loss (such as in the periods that depreciation expense or cost of sales is recognised); or
  - Removing the associated gains and losses that were recognised in net assets/equity and includes them in the initial cost or other carrying amount of the asset or liability.
- Cash flow hedge accounting is discontinued prospectively if:
  - The hedging instrument expires or is sold, terminated or exercised (net amount recognised in other comprehensive revenue and expense remains in net assets/equity until forecast transaction occurs and is then treated as described above).
  - The hedge no longer meets the criteria set out in the above block (net amount recognised in other comprehensive revenue and expense remains in net assets/equity until forecast transaction occurs and is then treated as described above).
  - The forecast transaction is no longer expected to occur (net amount recognised in other comprehensive revenue and expense is transferred immediately to surplus or deficit as a reclassification adjustment).
  - The entity revokes the designation (net amount recognised in other comprehensive revenue and expense remains in net assets/equity until forecast transaction occurs and is then treated as described above).

## FAIR VALUE HEDGE

- **Definition** - a hedge of the exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, or an identified portion of such an asset, liability or firm commitment, that is attributable to a particular risk and could affect surplus or deficit.
- Gain/loss from remeasuring the hedging instrument at fair value or the foreign currency component of its carrying amount is recognised in surplus or deficit.
- The gain/loss on the hedged item attributable to the hedged risk adjusts the carrying amount of the hedged item and is recognised in surplus or deficit.
- Fair value hedge accounting is discontinued prospectively if:
  - The hedging instrument expires or is sold, terminated or exercised.
  - The hedge no longer meets the criteria set out in the above block.
  - The entity revokes the designation.
- Adjustments to the carrying amount of a hedged financial asset for which the effective interest rate is used are amortised to surplus or deficit. The adjustment is based on a recalculated effective interest rate at the date amortisation begins.

## HEDGE OF A NET INVESTMENT IN A FOREIGN OPERATION

Hedges of a net investment in a foreign operation as defined in PBE IPSAS 4 – *The Effects of Changes in Foreign Exchange Rates*, including a hedge of a monetary item that is accounted for as part of the net investment, are accounted for similarly to cash flow hedges:

- The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised in comprehensive revenue and expense; and
- The ineffective portion is recognised in surplus or deficit.

The gain or loss on the hedging instrument relating to the effective portion of the hedge that has been recognised in other comprehensive revenue and expense is reclassified from net assets/equity to surplus or deficit as a reclassification adjustment on the disposal of the foreign operation.

## DESIGNATION OF NON-FINANCIAL ITEMS AS HEDGED ITEMS

If the hedged item is a non-financial asset or non-financial liability, it is designated as a hedged item (a) for foreign currency risks, or (b) in its entirety for all risks, because of the difficulty of isolating and measuring the appropriate portion of the cash flows or fair value changes attributable to specific risks other than foreign currency risks.