Agenda Item 5: Financial Instruments

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IPSASB Meeting
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Toronto, Canada
Session Outline

- Project management (5.2.1)
- ED development and specific issues (5.2.2-5.2.9)
- Draft ED (5.2.10) – any additional comments
- Hedge accounting education session
5.2.1 Project Management

- Convergence Project
  - Rules of the Road – Departures for public sector specific reasons

- Project Approach and Timelines
  - December 2016: IPSASB – vote on authoritative material & BCs
  - January – March 2017: TBG – review non-authoritative material
  - March 2017: IPSASB – final approval ED

**Matter for consideration:**
Does the IPSASB agree with the proposed approach and timelines?
5.2.2 ED Development

ED marked up from IFRS 9 to reflect:

- Terminology
- Interactions with other standards
- IPSAS 29 Public sector modifications
- Additional public sector modifications proposed
  - Concessionary loans vs. credit impaired loans
  - Equity Instruments arising from non-exchange transactions

**Matter for consideration:**
Does the IPSASB agree with the process to develop the ED?
5.2.3 Terminology Changes

<table>
<thead>
<tr>
<th>IFRS 9</th>
<th>IPSAS ED</th>
</tr>
</thead>
<tbody>
<tr>
<td>net income</td>
<td>revenue</td>
</tr>
<tr>
<td>profit or loss</td>
<td>surplus or deficit</td>
</tr>
<tr>
<td>other comprehensive income</td>
<td>net assets/equity</td>
</tr>
<tr>
<td>fair value through profit or loss</td>
<td>fair value through surplus or deficit</td>
</tr>
<tr>
<td>fair value through other comprehensive income</td>
<td>fair value through net assets/equity</td>
</tr>
<tr>
<td>group</td>
<td>economic entity</td>
</tr>
<tr>
<td>parent entity</td>
<td>controlling entity</td>
</tr>
<tr>
<td>subsidiary</td>
<td>controlled entity</td>
</tr>
<tr>
<td>business combination</td>
<td>entity combination</td>
</tr>
<tr>
<td>business model</td>
<td>management model</td>
</tr>
<tr>
<td>LIBOR</td>
<td>interbank offered rate</td>
</tr>
<tr>
<td>shareholder</td>
<td>entity's owner</td>
</tr>
<tr>
<td>reliable</td>
<td>faithfully representative</td>
</tr>
</tbody>
</table>

**Matter for consideration:**

Does the IPSASB agree with the proposed terminology changes in the ED?
5.2.3 Terminology Changes

- Use of “fair value” retained due to:
  - Fair value: IPSAS 34-38, *Interests in Other Entities* & IPSAS 39, *Employee Benefits*
  - Public sector measurement project

Matter for consideration:
Does the IPSASB agree with the continued use of “fair value” consistent with other recent IPSAS projects?
5.2.4 Reference to Other Standards

- General approach – Retain references only when current equivalent IPSAS exists

- References & related guidance dealt with as follows:
  - **IFRS 13** – IPSAS 29 fair value guidance; IE and/or IG to be developed/adapted
  - **IFRS 15** – Treatment of fees in effective interest method calculations retained; other references removed
  - **IFRS 3** – Amendment included for contingent consideration (consistent with Public Sector Combinations ED); other references removed

**Matter for consideration:**
Does the IPSASB agree with the proposals to deal with references to other standards?
5.2.5 Classification Principles

- Principled classification model for financial assets

Matter for consideration:
Does the IPSASB agree with the proposals in the ED related to the classification principles?
## 5.2.6 Measurement

<table>
<thead>
<tr>
<th>Classification</th>
<th>Asset</th>
<th>Measurement</th>
<th>Changes in Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair Value Surplus/Deficit</td>
<td>Debt/Equity/Derivatives</td>
<td>Fair Value</td>
<td>Surplus/Deficit</td>
</tr>
<tr>
<td>Fair Value Net Assets/Equity</td>
<td>Debt/Equity</td>
<td>Fair Value</td>
<td>Net Asset/Equity</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Debt Instruments when derecognized reclassified surplus/deficit</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Equity instruments not reclassified when derecognized</td>
</tr>
<tr>
<td>Amortized Cost</td>
<td>Debt</td>
<td>Amortized Cost</td>
<td>Effective Interest Method: Through Surplus/Deficit</td>
</tr>
</tbody>
</table>

**Matter for consideration:** Does the IPSASB agree with the proposals in the ED related to measurement?
5.2.6 Measurement – Unquoted Equity Instruments

- Proposal: fair value measurement for equities consistent with IFRS 9
  - Broadly consistent with existing guidance in IPSAS 29
  - Cost not consistent with classification principle introduced
  - Equity instruments held for objective other than profit in public & private sectors
  - IASB view that fair value provides the most relevant information

TBG & Staff propose development of illustrative examples/implementation guidance to help determine fair value
5.2.6 Measurement – Unquoted Equity Instruments

- Proposal: guidance on determining fair value consistent with IPSAS 29
  - IPSAS project on public sector measurement
  - Risk in prescribing particular measurement methods
  - Risk in removing onus on preparers to apply judgment to specific facts & circumstances
  - Convergence with IFRS - no compelling public sector reason to depart

TBG & Staff propose illustrative examples/implementation guidance be developed for valuation techniques to use for unquoted equity instruments

Matter for consideration:
Does the IPSASB agree with the proposals on the measurement of unquoted equities?
5.2.7 Equity Instruments Arising from Non-Exchange Transactions

- TBG debated guidance consistent with concessionary loans
- Equity investments to provide financing or a subsidy/grant
- Different economic substance vs. concessionary loans
  - Contractual cash flows and purchase price
  - Market terms
5.2.7 Equity Instruments Arising from Non-Exchange Transactions (Appendix D)

**Proposal A**
Application guidance in the ED:
- Requires assessment of grant portion of equity instrument;
- Does not explicitly define the “concessionary” element.

**Proposal B**
Application guidance similar to concessionary loans:
- Concessionary element = consideration in excess of FV of equity

**Proposal C**
No additional guidance proposed because:
- Significant differences between equity & debt instruments;
- Sufficient guidance exist in ED and IPSAS 23

**Matter for consideration:**
Does the IPSASB support the staff’s recommendation for Proposal C?
5.2.8 Impairment – ECL Model

**General Approach**
- 12 months ECL at inception
- Lifetime ECL if significant increase in credit risk

**Simplified Approach for Receivables**
- Lifetime ECL at initial recognition

**Purchase/Originated Credit Impaired Assets**
- Lifetime ECL at inception
- Credit adjusted EIR

**Matter for consideration:**
Does the IPSASB agree with the proposals included in the ED on impairment?
5.2.9 Application of ECL to Receivables

**Matter for consideration:** Does the IPSASB agree with no departure in authoritative guidance, development of illustrative examples & the proposed BC (5.2.9 – para 6)?

**Short-term Receivables <12 months**
- Loss provisions based on historical data likely approximates ECL due to short-term nature

**Receivables >12 months**
- Simplified approach removes requirement to track credit deterioration

**Flexibility and simplifications permitted:**
- Portfolio basis assessment
- Use of historical loss experience
- Use of provisions matrix
- Complex calculation not required
- Simplification for low credit risk
- 30 Days past due rebuttable presumption
- 12 months risk of default as proxy for lifetime risk
5.2.10 Securitization of Rights Arising from Sovereign Powers

Financial Instruments: Update of IPSAS 28-30

Sale of sovereign right—no F.I. to derecognize
Day 1 gain?

Initial set-up:

Originating Entity

- Transfers asset/group of assets
- Cash

Structured Entity

- Cash flows from securitized assets

Consolidate?

IPSAS 35

External Investor

- Transfers asset/group of assets
- Cash

Regular sale of F.I.
ED/IPSAS 29

Regular interest & principle
IPSAS 9 & ED/IPSAS 29

Subsequent cash flows:
5.2.10 Securitization of Rights Arising from Sovereign Powers

- Sufficient existing financial instruments guidance
  - Recognition, derecognition and measurement
- Sale of sovereign right — revenue recognition issue
  - Lack of a financial instrument
- Revenue guidance for non-financial instruments inappropriate in ED

**Matter for consideration:** Does the IPSASB agree with the sale of sovereign right being a revenue issue and not a financial instruments issue, and the proposed BC (5.2.10)?
5.2.10 Draft ED

• Any additional comments on the ED?

December 2016 plan:
• Hedge accounting, transition & BCs