Agenda Item 7: Financial Instruments

Ross Smith, Principal

December 6-9, 2016
IPSASB Meeting
Stellenbosch, South Africa
Session Outline

- Project management (7.1.1-7.1.3)
- ED development and specific issues (7.2.1-7.2.4)
- Instructions from September 2016 Meeting Actioned (7.2.5)
- Draft ED (7.10) – any additional comments
- CAG Update
Financial Instruments: Update of IPSAS 28-30

7.1.1 Project Management

September 2016:
• Agreed classification & measurement

December 2016:
• Review & agree-hedging, transition, & BCs

March 2017:
• Approval of authoritative guidance & amendments to other IPSASs

April 2017 TBG Meeting:
• April 19-21 at The Royal Netherlands Institute of Chartered Accountants

June 2017:
• Approval of draft ED
# 7.1.2 Decisions from September – Recap

<table>
<thead>
<tr>
<th>Topic</th>
<th>IPSASB Agreement</th>
<th>Key points of discussion</th>
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<tbody>
<tr>
<td><strong>Approach &amp; Terminology</strong></td>
<td>✓</td>
<td>Revenue, fair value, management model</td>
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<tr>
<td><strong>Classification Model</strong></td>
<td>✓</td>
<td>Principle-based guidance</td>
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<tr>
<td><strong>Measurement Model</strong></td>
<td>✓</td>
<td>Outcome of classification; fair value</td>
</tr>
<tr>
<td><strong>Expected Credit Loss Impairment Model</strong></td>
<td>✓</td>
<td>Applicability to public sector</td>
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Financial Instruments: Update of IPSAS 28-30

7.2.1 ED Development – Hybrid Instruments (1/4)

- What is a hybrid instrument
- Differences in accounting

<table>
<thead>
<tr>
<th>IPSAS 29</th>
<th>ED (IFRS 9)</th>
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<tbody>
<tr>
<td>• Separation (bifurcation) assessment</td>
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<td>• If required to separate, account for embedded derivatives on a stand-alone basis</td>
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<td>• Option to account for entire instrument at fair value through surplus or deficit</td>
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<tr>
<td>• No bifurcation</td>
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<td>• Classify &amp; account for in entirety</td>
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<td>• Application of guidance consistent with other F.I.s</td>
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7.2.1 ED Development – Hybrid Instruments (2/4)

• New requirements introduced due to:
  ➢ Significant cost and effort in identifying and separating embedded derivatives
  ➢ Reliability of estimating fair value of embedded components
  ➢ Entities often designate at fair value through surplus and deficit for simplicity
7.2.1 Hybrid Instruments – Puttable Instruments (3/4)

What are puttable instruments?

Capital subscriptions with redemption features

Classification & Measurement proposed in ED (holder):

- Financial asset – equity or debt
- SPPI & Management model
- Fair value measurement – often redemption price
Concessionary loans

A) Terms that give rise to fixed and determinable cash flows
   ➢ Basic lending arrangement → pass SPPI → amortized cost possible

B) Terms that give rise to contingent cash flows
   ➢ Unpredictable cash flows → likely fail SPPI → fair value through surplus or deficit
   ➢ Fair value more faithfully reflects uncertainty in timing and amount of cash flows
   ➢ Amortized cost provides less relevant information and is challenging to implement in this case

Matter for consideration:
Does the IPSASB agree with the proposals for hybrid instruments in the ED?
7.2.2 ED Development – Hedge Accounting

**Matter for consideration:**
Does the IPSASB agree with the hedge accounting proposals in the ED?

### Principle-based requirements

<table>
<thead>
<tr>
<th>Hedging Instruments</th>
<th>More inclusive: permits non-derivative FIs at fair value through surplus/deficit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hedged Items</td>
<td>More inclusive: permits risk components of non-financial items and synthetic and net positions</td>
</tr>
<tr>
<td>Hedge Effectiveness Test</td>
<td>More principle-based: removal of quantitative thresholds and retroactive testing, and permits use of existing risk management documentation</td>
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Option for entities to continue to apply hedge accounting requirements in IPSAS 29
### 7.2.3 ED Development – Transition

- **Paragraphs 149-176 of ED**
- Early adoption permitted
- Not required to restate comparatives
- Removed option for early adoption of own-credit provisions

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**Matter for consideration:**

Does the IPSASB agree with the transition proposals in the ED?
7.2.4 ED Development – Basis for Conclusions (Appendix D)

- Approach for retaining modifications made in IPSAS 29 (BC 4)
- IPSAS 29 BCs are appropriate to retain (BC 6-11)
- Public sector issues/modifications agreed by IPSASB
  - Equity instruments arising from non-exchange transactions (BC 12)
  - Public sector securitizations (BC 13)
  - Applicability of new impairment provisions to public sector entities (BC 14)

**Matter for consideration:**
Does the IPSASB agree with the BCs developed to date?
7.2.5 Instructions from September Actioned

- BC - replacing “income” with “revenue” (BC 5)
- Concessionary loans vs. credit impaired assets
  - Removal of additional paragraph proposed in September
- Public sector securitizations
  - AG33 and BC 13 noting possibility of financial liability to arise

**Matter for consideration:**
Does the IPSASB agree with the proposed actions?
CAG Update