

Meeting: International Public Sector Accounting
Standards Board

Meeting Location: Toronto, Canada

Meeting Date: December 8–11, 2015

Agenda Item 4

For:

☒ Approval

☒ Discussion

☐ Information

Financial Instruments: Update of IPSAS 28-30

Objective(s) of Agenda Item

1. The objective of the session is to approve the project brief on Financial Instruments.

Material(s) Presented

Agenda Item 4.1 Draft Project Brief, *Financial Instruments: Update of IPSASs 28-30*

Action(s) Requested

The IPSASB is asked to **consider** and **approve** the draft project brief in Agenda Item 4.1.

INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS BOARD

PROJECT BRIEF AND OUTLINE

1. Subject—Financial Instruments

- 1.1 IPSAS 28, *Financial Instruments: Presentation*, IPSAS 29, *Financial Instruments: Recognition and Measurement* and IPSAS 30, *Financial Instruments: Disclosures* are based on the IASB's financial instruments standards as at December 31, 2008.
- 1.2 This project will focus on updating IPSASs to maintain convergence with the IASB literature. IFRS 9, *Financial Instruments*¹ was issued in 2014, and mainly impacts IPSAS 29. However, the impact of IFRS 9 on other IPSASs will be considered. Further, other changes to the IASB financial instruments standards derived from IASB narrow scope amendments and improvements projects will also be considered.
- 1.3 The IPSASB has an active project to develop guidance for public sector specific financial instruments. The public sector specific financial instruments project deals with transactions which do not meet the definition of a financial instrument or those which are public sector specific.
- 1.4 Maintaining convergence with IFRSs is included as a key factor when considering project prioritization in the IPSASB's *Strategy for 2015 Forward*. Further, maintaining IFRS convergence is a key priority for some jurisdictions which have adopted and implemented IPSASs. Constituents in those jurisdictions note that unnecessary differences between IPSASs and IFRSs are costly and the IPSASB should continue reduce differences in a timely manner².

2. Project Rationale and Objectives

(a) Project rationale

- 2.1 The project rationale is that the IASB's financial instruments standards have been amended. If these changes are not considered and incorporated into IPSASs where appropriate, divergence will occur. Some constituents view the current IPSAS financial instruments requirements as more onerous than the current IFRS requirements.

(b) Objectives to be Achieved

- 2.2 The objective is to issue a revised IPSAS 29, *Financial Instruments: Recognition and Measurement*. Additional amendments to IPSAS 28, *Financial Instruments: Presentation* and IPSAS 30, *Financial Instruments: Disclosures* are also expected, however, those amendments are limited compared to the impact on IPSAS 29.

¹ The IASB has an ongoing project considering macro hedging requirements, which may lead to amendments to IFRS 9.

² Some jurisdictions have a mixed reporting model. With public sector entities applying IPSASs, but also controlling and consolidating private or quasi-public sector entities that report under IFRS or private sector national standards based on IFRS. These jurisdictions note that unnecessary differences are time consuming and costly from a consolidation point of view and that they should be eliminated in a timely manner where possible.

2.3 The intermediate objective is to produce an Exposure Draft (ED) of proposed changes.

Link to IPSASB Strategy

2.4 The project is consistent with the IPSASB's strategic objective of "strengthening public financial management and knowledge globally through increasing adoption of accrual-based IPSASs by developing high-quality public sector financial reporting standards". Further, it helps maintain convergence with IFRSs which is identified as a priority in the *IPSASB Strategy for 2015 Forward*.

Link to IFAC Strategic Plan

2.5 IFAC's Strategic Plan for 2013–2016, *Leading the Way*, has two strategic objectives to which this project responds:

- (a) An urgent focus on improved public sector financial reporting; and
- (b) The development, adoption and implementation of high-quality international standards.

3. Outline of the Project

(a) Project Scope

3.1 The scope of this project is to develop accounting requirements for financial instruments that are substantially converged with the IFRSs.

(b) Key Issues

3.2 A number of key issues are set out below. The list is not exhaustive.

Key Issue #1—Scope of the project?

3.3 The IASB issued the current version of IFRS 9, *Financial Instruments* in 2014. IFRS 9 resulted from the IASB's comprehensive review of IAS 39, *Financial Instruments: Recognition and Measurement*. The scope of this project is to update IPSAS 29, *Financial Instruments: Recognition and Measurement* which was developed based on IAS 39. This project will also consider other IASB financial instruments amendments since the introduction of IPSAS 28–30.

3.4 IPSAS 29 includes application guidance for concessionary loans and guarantees resulting from non-exchange transactions. Both transactions are subsets of items which are financial instruments, but have public sector applications. Similar to these transactions, public sector securitizations satisfy the definitions and requirements to be financial instruments. Therefore, this project will consider if additional application guidance should be included for public sector specific securitizations. However, this project will not consider other issues included in the public sector specific financial instruments project.

Key Issue #2—Classification and Measurement

3.5 The current classification in IPSAS 29 (based on IAS 39) is rule-based. The rules on classification drive the accounting requirements, including measurement and impairment. The IASB project to revise IAS 39, was undertaken to develop a more principle-based approach, with classification based on the business model and nature of the cash flows of the financial instruments. It also aimed to improve the impairment model for financial assets to address issues that arose out of the financial

crisis in 2008. Many believe that the incurred credit loss model resulted in financial institutions only recognizing impairments after the crisis was well underway. Key Issue #3 discusses the changes to the impairment requirements in more detail. Staff is of the view that the information provided on loan loss provisions is more relevant and faithfully representative under the IFRS 9 impairment model.

- 3.6 IFRS 9 introduces a conceptually based classification approach for all financial assets, including those with embedded derivative features. Two criteria are used to determine how to classify and measure financial assets; i) the entity's business model for managing the financial assets and ii) the contractual cash flow characteristics of the financial asset. IFRS 9 also modifies the requirements for reclassification of financial assets, only allowing classification changes when the entity's business model for managing the assets is modified.
- 3.7 IFRS 9 introduces limited changes related to accounting for financial liabilities. One revision relates to accounting for changes in an entity's own credit risk. Under IAS 39 and IPSAS 29, when an entity's own credit risk declines, the value of its liabilities decrease. When those liabilities are measured at fair value a gain is recognized, which appears counterintuitive. IFRS 9 introduces new requirements to present changes in the fair value of an entity's own credit risk in other comprehensive income (OCI). The IPSASB literature does not include OCI, therefore an alternative treatment will need to be considered if these changes are incorporated into IPSASs.

Key Issue #3—Impairment

- 3.8 IPSAS 29 and IAS 39 include an incurred loss impairment model. The incurred loss model requires evidence that an impairment trigger is present, before recognizing an impairment loss. During the financial crisis many believed that the incurred loss model led to the delayed recognition of credit losses on loans. This was identified as a weakness in the financial instruments standards and one that many believed contributed to the severity of the financial crisis. To respond to this issue, IFRS 9 introduces a new impairment loss model called the expected loss model. The model requires entities to recognize the expected credit losses at each reporting date, to reflect changes in credit risk. This model is forward looking, and no longer requires the identification of a triggering event before credit losses are recognized. This change intends to provide more timely information about expected credit losses on loans. IFRS 9 also removes the requirement in IAS 39 that entities can only consider those losses that arise from past events and current conditions. Another change IFRS 9 introduces is a single impairment model for all financial instruments subject to impairment accounting, replacing the complex requirements in IAS 39. Staff is of the view that the IFRS 9 impairment requirements provide more relevant and faithfully representative information for loan loss provisions than the current incurred loss model in IPSAS 29.

Key Issue #4—Hedge accounting

- 3.9 IFRS 9 establishes new hedge accounting requirements, with principles which allow a better link with the risk management practices of the entity. The objective of hedge accounting is to represent in the financial statements the impact of an entity's risk management activities when financial instruments are used to manage exposures arising from particular risks. Such risks include foreign exchange risk, interest rate risk and commodity price risk. When hedge accounting is applied the net effect of managing those risks is presented in the financial statements. IFRS 9 allows more flexibility to reflect actual risk management activities in the financial statements. IFRS 9 allows for components of financial and non-financial risk to be accounted for using hedge accounting. If a risk component can

be identified and measured, then hedge accounting can be applied. The new model also enables an entity to use internal information for management purpose as a basis for hedge accounting and simplifies the assessment of the hedging relationship. Because of the flexibility related to the documentation and testing of the hedge effectiveness, staff is of the view that the IFRS 9 requirements are less onerous than the current IPSAS requirements.

Key Issue #5—Public sector future flow transactions

- 3.10 Securitizations are contractual in nature and most schemes are common to both the public and private sector. IPSAS 29 includes requirements and detailed application guidance for securitization accounting. However, a specific type of transaction called “future flow” securitizations has been identified which may have applications unique to the public sector. These transactions allow an entity to securitize future cash flows for items which are not recognized in the statement of financial position. Such transactions for example include the securitization of future taxation rights by public sector entities. These transactions can have a significant impact on the statement of financial position and statement of financial performance of public sector entities. This project will consider the need to develop public sector specific guidance above what is included in IFRS 9 to deal with such transactions.

4. Describe the Implications for any Specific Persons or Groups

(a) Relationship to IASB

- 4.1 The project is integrally linked to the IASB’s new accounting standard for financial instruments, IFRS 9.

(b) Relationship to Other Standards, Projects in Process or Planned

- 4.2 There are links to the Conceptual Framework. There are also links to the public sector specific financial instruments project and the planned public sector measurement project.

(c) Other—Process for Reviewing and Modifying IASB Documents

- 4.3 The IPSASB policy document, *‘Process for Reviewing and Modifying IASB Documents’* will be followed, as the project is maintaining the alignment of existing IPSAS with the IFRS from which they are drawn.

5. Development Process, Project Timetable and Project Output

(a) Development Process

- 5.1 The development of outputs will be subject to the IPSASB’s formal due process. The approval of the ED will be subject to the usual IPSASB voting rules. As the project progresses, regular assessments will be made to confirm the proposed path in the project timetable remains the most appropriate. Staff is of the view that this project can be completed in a more time compressed manner compared with other non-convergence projects.

(b) Project timetable

Major Project Milestones	Expected Completion
Present draft Project Brief	December 2015
Development of Exposure Draft (ED)	June 2016—December 2016
Approve ED (four month comment period)	December 2016
Review of responses to ED	June 2017—December 2017
Approve revised IPSASs	December 2017

(c) Project output

- 5.2 The initial output will be an Exposure Draft converged with the underlying IFRS. The final output will be revised IPSASs 28–30³. The majority of the revisions will relate to IPSAS 29.

6. Resources Required

(a) Task Based Group

- 6.1 A Task Based Group will assist in overseeing the project.

(b) Staff

- 6.2 It is expected that 0.4 Full Time Equivalent (FTE) of staff resources is required for the project.

(c) Factors that might add to complexity and length

- 6.3 Factors that might add to the complexity and length of the project include:

- 6.3.1 IFRS 9, *Financial Instruments* is a new IASB standard with limited application at this time. Some of the new concepts may cause the IASB to consider amendments as the standard is implemented. Therefore, staff will monitor IASB developments to ensure that emerging issues are considered in this project as they arise.
- 6.3.2 The IASB has a project on macro hedge accounting which may lead to amendments to IFRS 9. The objective of the macro hedge project is to develop an approach to hedge accounting that better reflects entities' dynamic risk management activities in their financial statements. A discussion paper on macro hedging is under development and no guidance is expected in the near term. Staff will monitor the project progress and consider the public sector applicability of any guidance developed.

³ Depending on the complexity and volume of changes, the IPSASB may consider issuing a new financial instrument standard(s) to replace any or all of IPSAS 28–30. The benefits of the introducing IFRS 9 in a new standard(s) or as revisions to the existing IPSAS 28–30 standards, will be considered by staff and the IPSASB in project management discussions for this project.

7. Important Sources of Information

- 7.1 The principal information source of information will be the underlying IFRS on accounting for financial instruments. The IPSASB policy document '*Process for Reviewing and Modifying IASB Documents*' will also be followed in developing the ED and draft final pronouncement.
- 7.2 The IPSASB will monitor the experiences and progress of national standard setters which have projects related to developing financial instruments standards for the public sector based on IFRS 9.