

Meeting: International Public Sector Accounting
Standards Board

Meeting Location: Toronto, Canada

Meeting Date: September 20-23, 2016

Agenda Item 5

For:

- ☐ Approval
☒ Discussion
☒ Information

Financial Instruments (Updates to IPSAS 28-30)

Project summary	Development of an Exposure Draft to introduce the changes to the IPSASB suite of financial instruments standards to update for changes related to IFRS 9, Financial Instruments standard developed by the IASB. This is an IPSASB project intended to maintain convergence with IFRS financial instruments requirements.	
Meeting objectives	Topic	Agenda Item
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INSTRUCTIONS UP TO JUNE 2016 MEETING

Meeting	Instruction	Actioned
December 2015	The IPSASB noted that given the complexity and specialized nature of financial instruments accounting requirements, development of an educational item outlining the main changes in requirements from existing IPSAS financial instruments standards to the revised requirements may be useful.	See webinar developed to highlight key changes in IFRS 9 compared to IPSAS requirements: http://www.ifac.org/news-events/2016-08/financial-instruments-education-session

DECISIONS UP TO JUNE 2016 MEETING

Date of Decision	Decision
December 2015	Agreed the project is a convergence project, with the aim of maintaining convergence with the most recent version of IASB standards for the recognition and measurement of financial instruments IFRS 9. Further, that the IPSASB policy document, Process for Reviewing and Modifying IASB documents would be followed in considering changes introduced by IFRS 9.
December 2015	The IPSASB decided that consideration of additional application guidance for public sector specific securitizations (where future resources from, for example, sovereign rights, taxation rights or other rights not recognized in the statement of financial position are sold as part of a securitization scheme) should be considered.

Financial Instruments Update Project Roadmap

Meeting	Objective: IPSASB to consider:
September 2016	<ol style="list-style-type: none"> 1. Hedge accounting education session – continuation of June session 2. Review draft ED (authoritative guidance) – Objective, Scope, Classification & Measurement, & Impairment 3. Decision on terminology changes, existing public sector specific guidance, and public sector specific issues (e.g. concessionary loans) 4. Discussion on public sector securitizations
December 2016	<ol style="list-style-type: none"> 1. Review of full ED (authoritative guidance) including Hedge Accounting and Transition 2. Review draft Basis of Conclusions 3. Approval of authoritative guidance and BCs
TBG – post December	<ol style="list-style-type: none"> 1. Review of Implementation Guidance & Illustrative Examples
March 2017	<ol style="list-style-type: none"> 1. TBG reports on its review and approval of non-authoritative guidance 2. Approval of full ED on Recognition and Measurement 3. Review of consequential amendments (IAS 32*, IFRS 7* & others)
April 1, 2017	Consultation Period – ED: Financial Instruments Recognition & Measurement
August 1, 2017	
September 2017	<ol style="list-style-type: none"> 1. Initial Review of Responses on ED 2. Discussion on issues raised
December 2017	<ol style="list-style-type: none"> 1. Continuation of Review of Responses on ED 2. Review first draft of proposed IPSAS 3. Discussion on issues raised
March 2018	<ol style="list-style-type: none"> 1. Review and approval of final IPSAS on Financial Instruments- Recognition & Measurement

Project Management**Question**

1. Whether the Board approves of the proposed project management approach.

Detail

2. The project roadmap is included as [Issues Paper 5.1.3](#). The roadmap provides the expected timetable for issues discussion in the development of the authoritative and non-authoritative material to be included in the Exposure Draft (ED).
3. The IPSASB is asked to agree on the following proposed process:
 - (a) The IPSASB to review and vote on the authoritative material (main text of the standard and application guidance) and the Basis for Conclusions, at the December 2016 meeting;
 - (b) The IPSASB to delegate responsibility for detailed review of the non-authoritative material to the Task Based Group (TBG) (non-authoritative material includes; illustrative examples and implementation guidance);
 - (c) The TBG to complete a review of the non-authoritative material outside of meeting time from January—March 2017 and recommend any substantive issues to the IPSASB for discussion and approval. The IPSASB to approve entire ED in March 2016.

Decisions required

Does the IPSASB agree with the proposed approach?

Exposure Draft Development—Process

Question

1. Whether the Board approves of the process taken to develop the Exposure Draft (ED).

Detail

Project to Maintain IASB Convergence

1. The IPSASB approved the financial instruments project in December 2015 and decided the scope of the project is to maintain convergence with the relevant IASB standards.
2. Therefore, IFRS 9, *Financial Instruments* is used as the basis for developing the ED. Changes to IFRS 9 are reflected in the ED in mark up¹. The adaptations and modifications to IFRS 9 were incorporated to reflect:
 - (a) Adaptations to terminology – [see Issues Paper 5.2.3](#)
 - (b) References to other standards – [see Issues Paper 5.2.4](#)
 - (c) Public sector modifications already included in IPSAS 29. See discussion in paragraph 3 below.
 - (d) Consideration of additional public sector modifications arising from changes in concepts in IFRS 9 compared with IPSAS 29. Those changes will be considered in accordance with the IPSASB policy document, [Process for Reviewing and Modifying IASB Documents](#). See discussion in paragraph 4 below.

Public Sector Specific Modifications

3. IPSAS 28–30, Financial Instruments were developed as converged standards. IPSAS 29 includes public sector specific guidance which has been proposed in the ED as follows:
 - (a) Retention of guidance in IPSAS 29 to include an option to account for insurance contracts with transfer of financial risk as either a financial instrument or an insurance contract [²ED [Par. 2e](#)]; [AG 4-5](#)]
 - (b) Retention of the existing IPSAS 29 scope exclusion for service concession arrangements [ED [Par. 2k](#)]
 - (c) Retention of the existing guidance in IPSAS 29 to the derecognition criteria for financial assets/liabilities to accommodate non-exchange transactions. [ED [Par.13](#), [34](#), [36](#), [AG34 – 35](#)]
 - (d) Retention of existing guidance in IPSAS 29 for non-exchange revenue transactions [ED [AG105](#)]
 - (e) Retention of existing guidance in IPSAS 29 for Concessionary loans [ED [AG108-114](#)]

¹ For information purposes only—Text in green in the ED are included for information purposes only to provide the related references to IFRS 9 and IPSAS 29 where applicable. These references are included to identify the source of guidance proposed in the ED and will be removed when the ED is finalized.

² The square brackets “[...]” include hyperlinks to the various paragraphs in the ED related to the proposed text.

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- (f) Retention of existing guidance in IPSAS 29 for valuing financial guarantees issued through non-exchange transactions [[ED AG119-124](#)]
- 4. Additional public sector specific guidance is proposed in reviewing new proposed guidance in accordance with IFRS 9, as follows:
 - (a) Concessionary loans vs. credit impaired loans – IFRS 9 introduces the concept of purchased or originated credit impaired loans. Additional guidance is proposed in the ED to differentiate between these items from concessionary loans. [[ED AG115](#)]
 - (b) Equity instruments arising from non-exchange transactions – In reviewing measurement provisions of the proposed ED, a member of the Task Based Group (TBG) raised considerations for including additional guidance on equity instruments arising from non-exchange transactions. See discussion of alternatives proposed. – [see Issues Paper 5.2.7](#)
- 5. A marked up draft of the Exposure Draft is included in [Appendix H](#), and includes the authoritative guidance (core standard text and application guidance) for the following sections:
 - (a) Objective;
 - (b) Scope;
 - (c) Recognition and derecognition;
 - (d) Classification;
 - (e) Measurement (including impairment); and
 - (f) Defined Terms.
- 6. Hedge Accounting, transitional provisions and basis for conclusions will included in the ED for consideration in December 2016 as per the [Project Roadmap](#).

Decisions required

Does the IPSASB agree with the process to develop the ED?

Exposure Draft Development—Terminology

Question

- Whether the Board approves of the decisions taken in modifying terminology from IFRS 9 in the development of the Exposure Draft (ED).

Detail

- The following table summarizes changes included in the ED to adapt terminology for consistency in IPSAS literature and the public sector.

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

- The Task Based Group questioned if 'fair value' is an appropriate term to use in the financial instruments update project and suggested that market value be considered because it has been included as a measurement basis in the Conceptual Framework. However, fair value has been retained in the ED for the following reasons:
 - The IPSASB has agreed to continue the use of 'fair value' since the completion of the Conceptual Framework, in the projects to develop IPSAS 34-38, *Interests in Other Entities*, IPSAS 39, *Employee Benefits* and the public sector combinations ED.
 - The IPSASB has an approved project on public sector measurement that will consider and deal with measurement across all standards.

Decisions required

Does the IPSASB agree with:

- The proposed terminology changes integrated into the ED; and
- The continued use of 'fair value' consistent with other recent IPSASB projects?

Exposure Draft Development—References to Other Standards**Question**

1. Whether the Board approves of decisions taken in the development of the Exposure Draft (ED) in regards to references to other standards.

Detail

2. **General approach:** When references to other standards appear in IFRS 9, those references are only retained when a current equivalent IPSAS exists.
3. The following references and related guidance have been removed because an equivalent current IPSAS does not exist:
 - (a) **IFRS 13**—References to fair value under IFRS 13 removed.
 - (i) Proposal to carry forward existing IPSAS 29 fair value guidance. [ED [Par.63-65; AG131- 143](#)]
 - (ii) Staff to consider and develop additional public sector specific fair value illustrative examples and implementation guidance.
 - (b) **IFRS 15**—See [Appendix A](#) for proposed treatment of IFRS 15 references. Only one IFRS 15 reference has been retained which is a consequential amendment clarifying treatment of fees in effective interest method calculations.
 - (c) **IFRS 3**—A consequential amendment to IFRS 3 retained, related to the treatment of contingent consideration recognized by an acquirer, which requires measurement at FV. Amendment included consistent with proposals in the public sector combinations ED. [ED [Par. 44 e\)](#)]

Decisions required

Does the IPSASB agree with the proposals to deal with references to other standards in the ED?

Exposure Draft Development—Classification Principles

Questions

- Whether the Board approves the proposals included in the ED for classification.

Detail

- The ED introduces a new classification model for financial assets (consistent with IFRS 9). The new model provides a principles-based approach to classification, which better reflects the entity's asset management practices and the economic nature of the instruments, compared to the existing IPSAS 29 model.
- Financial assets are mandatorily classified into the four categories referenced in paragraph 3, based on the following:
 - Management model – Based on an entities intentions for holding the asset and the management model for the asset. The principle sets out different management models (hold to collect, hold to collect and sell, and fair value through surplus and deficit); and
 - Contractual cash flow characteristics – Also known as the solely payments of principle and interest (SPPI) test, which addresses whether the cash flows of the instrument are representative of a basic lending arrangement.
- The new classification categories as applicable to various types of financial assets as follows:

	Debt Instruments	Equity Instruments	Derivative Instruments
Fair value through surplus and deficit	√	√	√
Fair value through net assets/equity ³	√	√	
Amortized Cost	√		

- The classification model for financial liabilities remains substantively the same as IPSAS 29.
- The IPSASB policy document, [Process for Reviewing and Modifying IASB Documents](#), has been followed in considering the impact of the changes to classification introduced on IFRS 9. Based on the analysis staff does not propose and public sector departures from the IFRS 9 classification model. The analysis is included in the [Appendix B](#).

Decisions required

Does the IPSASB agree with the proposals in the ED related to the classification principle?

³ There is a distinction between the fair value through net assets/equity category for debt instruments, and the irrevocable option election at inception available for equity instruments to be accounted for as fair value through net assets/equity. The measurement difference is outlined in [Issues Paper 5.2.6](#).

Exposure Draft Development—Measurement

Questions

- Whether the Board approves of the proposals included in the ED for measurement.

Detail

- In IFRS 9, similar to IPSAS 29, measurement is prescribed based on the classification of the respective financial instruments. The ED proposes two primary measurement categories: fair value being the primary measurement basis, and amortized cost which is permitted only for certain debt instruments⁴.
- As a result of the principles based model for classifying financial assets (see [Issues Paper 5.2.5](#)), achieving a measurement outcome from an arbitrary designation of the financial asset as currently permitted under IPSAS 29 is no longer attainable. Instead, the measurement basis including where changes in value are recognized, is a consequence of the mandatory classification of the financial asset based on its management model and cash flow characteristics.
- The table below specifies the measurement of each classification category of financial assets, and the types of financial assets the category may apply to.

Classification	Type of Financial Asset	Measurement
Fair value through surplus and deficit	Debt/Equity/ Derivatives	Measured at fair value. Changes in fair value recognized in surplus/deficit.
Fair value through net assets/equity	Debt	Measured at fair value. Changes in fair value recognized in net assets/ equity which is reclassified to surplus/ deficit upon derecognition of financial asset.
	Equity	Measured at fair value. Changes in fair value recognized in net assets/equity, and remain in there even upon derecognition of financial asset (never reclassified to surplus/deficit).
Amortized Cost	Debt	Measured at amortized cost using the effective interest method.

- The only substantive change to measurement of financial liabilities, relates to those measured at fair value. The ED requires changes in fair value due to deterioration in an entities own credit risk to be recognized in net assets/equity, rather than surplus/deficit as required under IPSAS 29. This eliminates the recognition of a gain as a result of deterioration of an entities own credit risk.
- The TBG raised issues to consider related to measurement of unquoted equity instruments. A full discussion and analysis is included in [Appendix C](#). The TBG and staff agreed to the following approach to the issues:

⁴ The amortized cost category is only permitted under IFRS 9 for debt instruments that have a hold-to-collect business model and the contractual terms (and the resulting cash flows) resemble that of a basic lending arrangement. This is because the objective of the effective interest method is to allocate interest revenue/expense over the relevant period, and interest is consideration for the time value of money and the credit risk associated of the issuer (i.e. key elements of return in a basic lending arrangement). Therefore amortized cost measured using effective interest method only provides relevant information to those particular instruments.

Should unquoted equity instruments be permitted to be measured at cost?

7. It was agreed that the authoritative guidance should not be amended to permit cost, due to:
 - (a) IPSAS 29 requires unquoted equity instruments to be measured at fair value and permits cost only when fair value cannot be reliably measured. IFRS 9 requires fair value and allows cost measurement when it approximates fair value.
 - (b) Permitting cost as a third measurement category introduces a departure from IFRS that is:
 - (i) Inconsistent with the principles-based approach to classification of financial assets;
 - (ii) Inconsistent with the IPSASB policy document, [Process for Reviewing and Modifying IASB Documents](#), as unquoted equity investments are held for purposes other than profit in both the public and private sector, the economics of which are similar.
 - (c) Fair value accounting as required in the ED provides the most relevant information. However, it was agreed that additional illustrative examples and implementation guidance should be developed to help preparers with determining fair value of unquoted equity instruments, which is noted as a challenge for preparers.

Should additional application guidance be included to prescribe requirements on the appropriate method to value unquoted equity instruments, such as permitting the net asset value method?

8. It was agreed that public sector specific illustrative examples and implementation guidance be developed to demonstrate how certain valuation techniques may be applied to value unquoted equity instruments. In the development of such guidance, an [IASB education document](#), which was developed to support IFRS 13 and provides illustrative examples for valuation of unquoted equity instruments, will be referenced.
9. Modifying the authoritative guidance is not recommended primarily due to the following:
 - (a) The IPSASB has a committed project on public sector measurement, which will assess the measurement requirements across all IPSASs and consider the applicability of fair value;
 - (b) The risk in prescribing particular measurement method(s) over others is that it may result in misuse of certain valuation techniques;
 - (c) The risk in implicitly removing the requirement for management to apply judgment in assessing facts and circumstances, and instead, default to using valuation technique(s) prescribed which may be inappropriate given the economics of the transaction;
 - (d) Existing guidance in IPSAS 29 is thought to be sufficient and has been proposed in the ED.

Process for Reviewing and Modifying IASB Documents

10. The IPSASB policy document, [Process for Reviewing and Modifying IASB Documents](#), has been followed in considering the applicability of fair value—specific to unquoted equity instruments. Based on the analysis staff does not propose any public sector departures from the measurement requirements in IFRS 9 for unquoted equity instruments.

Decisions required

Does the IPSASB agree with the staff and TBG proposals that:

- No changes are proposed to the ED measurement provisions;
- Illustrative examples and implementation guidance be developed or adapted to demonstrate application of certain valuation techniques to unquoted equity instruments in the public sector.

Exposure Draft Development—Equity Instruments Arising from Non-Exchange Transactions

Questions

1. Which of the three proposals does the Board agree with in relation to equity instruments arising from non-exchange transactions?

Detail

2. A member of the Task Based Group (TBG) noted that in the public sector, equity instruments are sometimes obtained with minimal cash flow expectations as a way of providing funding or subsidy to another public sector entity for providing a service. These equity instrument are acquired at non-market terms, and are therefore “concessionary” in nature. As such, additional guidance mirroring guidance in IPSAS 29 on concessionary loans, should be included in the ED.
3. While staff acknowledges the prevalence of such transactions in the public sector, staff also has reservations with the proposed approach (see detailed analysis in [Appendix D](#)), due to differences in economic substance of such transactions compared to concessionary loans, including:
 - (a) Fixed and determinable contractual cash flows of a loan compared to variable and unpredictable cash flows from an equity instrument, making it challenging to apply the concept of “concessionary” to equity instruments at inception;
 - (b) The ability to define “market terms” of a debt instrument given its simple return structure, compared to the complexity in determining what “market terms” are for unquoted equity instruments as a result of the multitude of factors which impact their market value; and
 - (c) The prevalence of premiums and discounts in acquiring equity instruments for strategic or operational reasons which are not concessionary in nature, compared to debt instruments which are generally transacted at market terms in an arms-length exchange transaction.
4. In light of such reservations, and acknowledging the TBG’s concern, staff has developed three alternative proposals to address unquoted equity instruments that arise from such a transaction.
 - (a) [Proposal A](#): additional application guidance to acknowledge such transactions in the public sector, requiring entities to assess if a grant is inherent, without explicitly defining “concessionary” element; this is the approach currently reflected in the [draft ED](#);
 - (b) [Proposal B](#): additional application guidance similar to concessionary loans, with the “concessionary” element defined as consideration in excess of the fair value of the equity.
 - (c) [Proposal C](#): no additional guidance proposed.

See [Appendix D](#) for the proposed application guidance and advantages and the disadvantages of the approach.
5. With consideration of the reservations noted above, staff is of the view that guidance in IFRS 9 on the recognition and measurement of unquoted equity instruments combined with guidance on non-exchange transactions in IPSAS 23, sufficiently addresses such transactions, therefore recommends Proposal C.

Decisions required

Does the IPSASB support staff’s recommendation that Proposal C (no additional guidance) be adopted in the ED? If not, which proposal does the IPSASB support?

Exposure Draft Development—Impairment

Question

1. Whether the Board approves of the proposals included in the ED for impairment.

Detail

1. The expected credit loss (ECL) impairment guidance in the ED (drawn from IFRS 9) is a forward looking model. It was developed by the IASB to respond to criticisms that the current incurred loss model delays recognition of impairment losses. The ECL model distinguishes between financial instruments that have experienced a significant deterioration in credit quality from those that have not. As a result it provides a better estimate of the economic credit loss incurred throughout a financial instrument's life cycle.
2. The ED proposes a dual-measurement impairment approach that requires a 12 month ECL to be recognized initially, and subsequent recognition of lifetime ECL if a significant increase in credit risk occurs. A simplified approach that allows recognition of lifetime ECL at inception is available for trade and lease receivables.
3. For purchase or originated credit impaired financial assets, the ED includes a specific approach requiring recognition of lifetime ECL at inception to reflect their credit impaired status, and use of a credit adjusted effective interest rate in determining interest revenue.
4. The proposed model requires consideration of reasonable and supportable information available without undue cost or effort on past events, current conditions and future forecasts.
5. To minimize application challenges and reduce cost and effort in implementation, the model provides:
 - (a) Flexibility in developing a model for measuring ECL based on facts and circumstances, without specifically prescribed methods;
 - (b) An option to assess credit risk on an individual or collective portfolio basis;
 - (c) Simplifications provided for instruments with low credit risk;
 - (d) Practical option available under certain circumstances, to use the 12 months credit risk as an approximation for lifetime credit risk for certain instruments;
 - (e) A rebuttable presumption to use 30 days past due as an indicator of a significant increase in credit risk, to assist in situations where there is a lack of reasonable and supportable forward looking information.
6. The TBG raised an issue on to the applicability of the ECL model to receivables, considered in [Issues Paper 5.2.9](#).
7. The IPSASB policy document, [Process for Reviewing and Modifying IASB Documents](#), has been following in considering the ECL model and its applicability to the public sector. Based on the analysis public sector departures from the IFRS 9 impairment model are not proposed. See the discussion included in [Appendix E](#).

Decision required

Does the IPSASB agree with the proposals in the ED related to impairment?

Application of Expected Credit Loss Model to Receivables

Question

1. Is the proposed impairment model appropriate for public sector entities with mainly receivables as financial assets?

Detail

2. A TBG member noted concerns that the expected loss impairment model can be complex and many public sector entities may have mainly receivables as financial assets.
3. A further concern was that some public sector entities do not have a choice in the counterparties they transact with, because of laws and regulation (e.g. hydro supplier, water utility). Therefore, credit risk information may not be available on an individual basis (e.g. student loan example).
4. A full analysis is included in the [Appendix F](#). The TBG and staff agreed the following approach.

Loans and other debt instruments—General Approach to Impairment:

5. Public sector specific illustrative examples to be developed or adapted to demonstrate application of impairment assessments on a portfolio level when appropriate. This was agreed based on:
 - (a) The ED already incorporates practical and operational simplifications to make impairment assessments easier in practice (such as permitting analysis on a portfolio level) and;
 - (b) Similar issues relating to receivables are experienced in both the public and private sectors

Receivables—Estimating Expected Credit Loss (ECL) and the Simplified Impairment Approach

6. Public sector illustrative examples to be developed or adapted to demonstrate the application of the simplified approach to ECL for receivables. Further, staff recommends a BC as follows:

“The IPSASB notes that for many public sector entities, receivables may be the only significant financial asset held. In addition, public sector entities may not have an ability to choose the counterparties they transact with because of the nature of services provided and laws or regulations requiring provision of services to all service recipients (for example, when a public utility provides water or hydro services). Under such scenarios, credit risk information at an individual counterparty level and forward looking information/forecasts may not be available without undue cost or effort. The IPSASB considered whether public sector modifications or additional guidance should be included in the Standard and concluded that the simplified approach for receivables along with practical expedients available in determining expected credit losses provide appropriate relief to the practical challenges under such scenarios. The IPSASB further acknowledges that the Standard allows for historical data and existing models be incorporated in estimating expected credit losses under such circumstances with consideration for any adjustments as needed to reflect current and forecasted conditions, as prescribed in the Standard.”

Decision required

Does the IPSASB agree with:

- No departure in the authoritative guidance on impairment requirements to loans and receivables;
- Development/adaptation of illustrative examples to demonstrate application of the impairment requirements and the simplified approach to public sector entities; and
- The proposed BC?

Securitizations of Rights Arising From Sovereign Powers

Questions

1. Whether additional guidance on public sector securitizations is needed in the financial instruments standard.

Detail

1. Securitizations in the public sector can be categorized into two types:
 - (a) Securitizations of recognized assets on the statement of financial position (e.g. tax receivables), similar to securitization schemes widely observed in the private sector.
 - (b) Securitizations of a sovereign right related to a future-flow transaction (e.g. right to future taxation rights) that is not a recognized asset on the statement of financial position, because it does not meet the recognition criteria as a past event has not occurred.
2. The term “securitization” is not explicitly defined under IFRS, but refers to the practice of pooling together assets and transforming them into a security by selling their related cash flows to third party investors.
3. The public sector securitizations issue identified is the treatment of the transaction to sell future-flows that arise from sovereign powers (paragraph 1 b) above).
4. Staff and the TBG discussed the issue and concluded that:
 - (a) The first step in a future-flow securitization transaction arising from sovereign powers is the sale of a sovereign right rather than derecognition of a financial asset, given that the sovereign right does not meet the asset recognition criteria;
 - (b) The accounting for the sale of sovereign rights, is a revenue recognition issue, not a financial instruments recognition and measurement issue; and
 - (c) Guidance covering subsequent steps and accounting implications of securitization schemes is included in the ED for the financial instruments aspects of such transactions (consistent with IPSAS 29). Consolidation of securitization vehicles are addressed in IPSAS 35 *Consolidated Financial Statements*. See full analysis of the issue in [Appendix G](#).
5. A BC is proposed to acknowledge that sales of sovereign sovereign powers is a revenue issue and not a financial instruments issue. The proposed BC is as follows:

“In the public sector, there are securitization schemes involving a sale of future flows arising from a sovereign right, such as right to taxation. The IPSASB considered whether public sector modifications or additional guidance is needed in the standard to address such transactions. The IPSASB decided because rights arising from sovereign powers relate to future events, the recognition criteria are not met and an asset is not recognized. Therefore the sale of future flows arising from rights is a revenue transaction that should be accounted for in accordance with the relevant revenue guidance. The IPSASB further concluded that sufficient guidance exists in the Standard to address recognition and measurement of any financial assets and liabilities arising from such transactions.”

Decisions required

Does the IPSASB agree with:

- The proposed approach to public sector securitizations in the ED; and
- The proposed BC?

Appendix A: ED Development—Treatment of References to IFRS 15

Proposals on approach to deal with references to IFRS 15 in the ED

References Replaced/Removed

1. Reference to IFRS 15 generally replaced with reference to both IPSAS 9 & 23 [ED [Par.3](#)], with the exception of:
 - (a) Scope exclusion for receivables arising from non-exchange transactions [ED [Par.2j](#)], [AG 6](#)]
2. Removal of references to performance obligations approach:
 - (a) In the accounting for continuing involvement of transferred assets, IFRS 9 requires the fair value of the financial guarantee to be recognized in surplus/ deficit when the obligation is satisfied under IFRS 15. Given the lack of the performance obligations approach in IPSAS, guidance from IPSAS 29 was carried over in place of the reference to IFRS 15, to recognize the guarantee on a time proportion basis in accordance with IPSAS 9. [ED [AG25 a](#)]
3. Removal of any references to “contract assets” and “significant financing components” as both concepts do not exist under current IPSAS 9 and IPSAS 23, and are new concepts defined under IFRS 15 [ED [Par.70, 84](#)]
4. Removal of requirement to measure receivables at the transaction price [ED [Par.56-57](#)]. This relates to a consequential amendment made to IFRS 9 as a result of IFRS 15, and the guidance for determination of transaction price is contained in IFRS 15. This amendment is not proposed in the ED because of the ongoing revenue project which is considering such issues.
5. Removal of measurement guidance for when fair value differs from transaction price [ED [AG107](#)]. Similar to paragraph 4, this was a consequential amendment to IFRS 9 from IFRS 15. The concept of transaction price is pervasive in IFRS 15. For examples, IFRS 15 includes more guidance on situations where transaction price is and is not an appropriate indication of fair value. Given the lack of this guidance in existing IPSASs, staff recommends deferring the adoption of this amendment until the completion of the revenue project.

References Retained

6. Retention of consequential amendment to IAS 39 as a result of IFRS 15 that adds clarification to the types of fees to be included in the calculation of the effective interest and replacing reference to IFRS 15 with IPSAS 9 [ED [AG145](#)]. The amendment has a minimal impact on other parts of the standard and therefore is included in the ED.

Appendix B: ED Development—Classification Model

Detail

1. IFRS 9 introduces a new classification model for financial assets. The new model provides a principles-based approach to classification, which better reflects the entity's asset management practices and the economic nature of the instruments, compared to the existing IPSAS 29 model. See [Issues Paper 5.2.5](#) for an outline of the model.

Analysis—Process for Reviewing and Modifying IASB Documents

2. The IPSASB's policy paper requires an assessment on whether public sector issues warrant a departure from the proposed IASB requirements. This assessment includes:
 - (a) Whether applying the requirements of the IASB document would mean that the objectives of public sector financial reporting would not be adequately met;
 - (b) Whether applying the requirements of the IASB document would mean that the qualitative characteristics of public sector financial reporting would not be adequately met; and,
 - (c) Whether applying the requirements of the IASB document would require undue cost or effort.

Objectives of public sector financial reporting

3. According to paragraph 2.1 of The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities, the objectives of financial reporting are "to provide information about the entity that is useful to users of GPFRs for accountability purposes and for decision-making purposes".
4. Staff is of the view that the proposed classification model in the ED meets the objectives of public sector financial reporting because:
 - (a) It enhances accountability because the new classification model requires mandatory classification into prescribed categories of financial assets based on an assessment of management intentions together with consideration of its contractual characteristics. This factual approach to classification removes the ability for the reporting entity to arbitrarily choose one category over another as permitted under IPSAS 29. The categorization of a financial instrument under IFRS 9 can also only be reclassified, when the management model changes, which further limits the ability to manage an accounting outcome.
 - (b) It enhances decision-making in regards to such investments, as it provides more relevant information to reflect the economic substance of these investments and how they are being managed, for example, through the creation of a fair value through other comprehensive income category for equity instruments, users can more easily distinguish between equity investments held for strategic or operational purposes that the entity does not intend to sell in the foreseeable future from those held with project objective, and better assess the impact of these investments to the entity's financial performance and operations.

Qualitative characteristics of public sector financial reporting

5. Staff is of the view that the proposals in the ED related to the expected loss impairment model would benefit the following qualitative characteristics (QC) (compared to the existing incurred loss model included in IPSAS 29):

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- (a) Understandability – The new classification model requires measurement at fair value in all categories, the real differentiating factor for the various categorization is where in the financial statements changes in fair value are recognized. The new categories and fair value measurement ensure that each grouping of instruments has similar characteristic and intentions for being held and therefore, provides better understandability.
- (b) Comparability – The principle to classification improves comparability with other entities because the more stringent principle ensures that the various categories now are comparable from one entity to another, compared to the purely intention based approach in IPSAS 29.
- (c) Faithful representation – Allows a more faithful representation of the impact on an entity's financial position and performance of investing in each category of financial asset;
- (d) Relevance – Aligning each category of financial instruments with certain cash flow characteristics and management models provides more relevant information to the user in interpreting an entity's investment strategy, the composition of its financial asset and liability, and forecasting the impact of such instruments on the entity's financial performance and cash flows.
- (e) Verifiability – The proposed principles based approach to classification is a matter-of-fact assessment based on objective evidence rather than an assertion, which improves the variability of the model.
- (f) Timeliness – Regardless of the categorization of financial instrument, financial assets to be carried at fair value, which provides timely information on the current value.

Undue cost or effort in applying the requirements of the IASB

5. Staff does not believe applying the new categorization is overly complex or would require additional undue cost and effort. Rather, staff is of the view that the categorization being more principles based and less arbitrary, should help ensure it is more consistently applied and with less effort compared with the rules-based classification in IPSAS 29.

Recommendation

Based on the guidance in the Process for Reviewing and Modifying IASB Documents and the IPSASB Conceptual Framework and the analysis above, a departure from the new classification model is not proposed.

Appendix C: ED Development—Measurement of Unquoted Equity Instruments

1. In reviewing the proposals in the ED for measurement of unquoted equity instruments, members of the TBG raised the following questions:
 - A. *Should certain unquoted equity instruments be permitted to be measured at cost instead of fair value;*
 - B. *Should additional application guidance on fair value measurement be included on valuation techniques, for example, specifically permitting the use of the net asset value as a method of valuing unquoted equity instruments; and*

Staff considered the comments raised and analyzed below.

A. Should certain unquoted equity instruments be permitted to be measured at cost instead of fair value?

Detail

1. IPSAS 29⁵ requires fair value measurement for unquoted equity instruments. However, the guidance includes an exception to fair value measurement when fair value cannot be reliably measured, in which case measurement at cost is permitted [*IPSAS 29 Par. 48 c*].
2. IFRS 9 removes this exception and requires all equity instruments to be measured at fair value, but instead, acknowledges in its application guidance that cost may be an appropriate estimate of fair value under certain circumstances.
3. Specific members of the TBG had raised concerns as follows:
 - (a) The cost exception was widely used for unquoted equity instruments under IPSAS 29, and the more stringent requirements under IFRS 9 may pose application challenges for preparers.
 - (i) Staff notes that while a cost exception to fair value measurement existed under IPSAS 29, the Standard does not suggest that cost is a default category for unquoted equity instruments. The spirit of the Standard (consistent with IAS 39) is to measure these unquoted equity instruments at fair value, and permit cost when “fair value cannot be reliably measured” which is a high hurdle⁶.
 - (ii) The IASB removed the measurement exception in unquoted equity instruments (and derivatives on them) because measuring those instruments at fair value provides the most relevant information to users of financial statements, because, although cost is a reliable and objective amount, it provides little, if any, information with predictive value about the timing, amount and uncertainty of future cash flows arising from the instrument [*IFRS 9 BCE.66*].

⁵ The IPSAS 29 requirements are consistent with the requirements of IAS 39.

⁶ Staff’s experience in applying IAS 39 in the private sector and in auditing entities applying IAS 39, was that unquoted equity instruments can usually be reliably measured and instances of use of cost under IAS 39 was extremely limited and rare.

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- (b) Public sector entities often makes equity investments in other entities which are not quoted in the active market. These investments have a service provision objective, rather than to generate profits. Such transactions are thought to be voluminous in the public sector, and therefore a cost measurement basis may more appropriate.
- (i) Staff acknowledges that public sector entities often invest in in the equity of other entities to support the objective of service delivery rather than generation of profits. However, staff believes that to further a service delivery objective, public sector entities would need to exert control over the investment in some manner which would generally lead to a controlled or significant influence investment.
 - (ii) Unquoted equity investments within the scope of the ED are limited to those that do not give rise to significant influence or control (notwithstanding accounting in separate financial statements discussed in paragraph (c) below). Despite unquoted equity investments being prevalent in the public sector, the measurement provisions in the ED only apply to a narrowly defined population.
 - (iii) Public sector investments, such as an investment in a development bank, do not have a different economic substance than similar strategic investments in the private sector (investments of a strategic, operational, or regulatory nature). This is demonstrated through the below example that compares such investments in both sectors:

	Public Sector Example: <i>Membership Shares in Development Bank Held by Government</i>	Private Sector Example: <i>Membership Shares in Clearing House Held by Financial Institution</i>
Profit Objective	None – held for objective of funding an organization to provide services or to achieve specific government policy objectives	None – held for the objective of facilitating daily operations and/or strategic objectives
Plan for Resale	None – entity does not foresee selling the investment in the foreseeable future	None – entity does not foresee selling the investment in the foreseeable future
Existence of Active Market	None – No active market exists for such membership shares, other than potential buybacks from the originating entity	None – No active market exists for such membership shares, other than potential buybacks from the originating entity
Dividend Terms	May not have any dividend terms attached	May not have any dividend terms attached
Forecasted Future Cash Flows	Forecasted future cash flows likely not readily available due to lack of dividend terms.	Forecasted future cash flows likely not readily available due to lack of dividend terms.
Market Comparables	Direct market comparables likely not available given the unique nature of these membership shares	Direct market comparables likely not available given the unique nature of these membership shares

- (iv) In the IASB's view, fair value provides the most useful information about investments in equity instruments (as noted above). To capture the economic substance of such an investment without contradicting this principle, IFRS 9 permits an entity to make an irrevocable election to present changes in the value of any investment in equity instruments that is not held for trading, in other comprehensive income (OCI) (net

assets/equity as proposed in the ED, consistent with IPSAS framework), which removes the volatility of such investments from profit or loss.

- (v) The classification and measurement model under IFRS 9, introduces a principled approach that requires an assessment of both the management model and the economic characteristics (i.e. SPPI) of financial instruments when assessing classification (principled classification determines the appropriate measurement). This is a fundamental change from the rule-based classification model under IAS 39/IPSAS 29 that focuses primarily on intentions to determine classification and measurement.
 - (vi) Equity instruments by nature, do not pass the SPPI test, because the cash flow and economic characteristics of equities do not represent that of a basic lending arrangement, regardless of management's intentions for holding them (e.g. for profit or service potential). As a result, the underlying principles in the new classification framework requires equity instruments to be measured at fair value through surplus or deficit, unless an election is made for fair value through net assets/equity as described above.
 - (vii) Introducing a departure for unquoted equity instruments where management's intention is to hold such instruments for service potential, to be measured at cost would establish a third measurement category for equities, which is contradictory to the reason the new principled based classification guidance was developed.
- (c) Cost is one of the permitted measurement options for significant influence equity investments and investments in controlled entities under IPSAS 34, Separate Financial Statements.
- (i) IPSAS 34 provides three options to account for controlled or significant influence investments, including cost, equity method accounting or as a financial instrument. The scope of such equity instruments is not to be confused with unquoted equity instruments that fall within the scope of the ED, which pertain to equity instruments with ownership interest of less than 20% (i.e. do not give rise to control or significant influence). IPSAS 34 does not allow cost measurement on financial instruments that are within the scope of IPSAS 29.
 - (ii) In addition, for investments involving control or significant influence, staff notes that while cost is a permitted measurement option under IPSAS 34, it is not an allowed measurement basis upon consolidation for either type of investments, given that it is not viewed as providing useful and relevant information for a consolidated entity. The options available under IPSAS 34 for such investments are in line with other concessions built into the requirements for separate financial statements. These options are allowed because of the underlying assumption that more relevant information is provided in the consolidated financial statements and which are available to the users of the separate financial statements. As such, IPSAS 34 is not relevant to the decision on the appropriate measurement basis for unquoted equity instruments in the ED because of the differences in its scope and applicability.
- (d) There is often resource constraints and a lack of valuation expertise in the public sector, which creates significant challenges for determining the fair value of such unquoted equity investments in the public sector.
- (i) Staff acknowledges the practical challenges in determining the fair value of unquoted equity investments in the public sector and notes that those same challenges exist

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in the private sector. Staff considered whether additional guidance or examples should be added to assist preparers in determining fair value (see discussion point B below).

- (ii) A TBG member noted in addition, that even if cost measurement was permitted for unquoted equity instruments, the instruments would still need to be tested periodically for impairment. The impairment assessment would involve either a fair value or a value in use assessment, based on a discounted cash flow or a replacement cost approach. The work and effort required in such an exercise is no less extensive or onerous than determining the fair value of the instrument, given that a value generated through a discounted cash flow or replacement cost estimation can generally be seen as an approximation for fair value.
- (iii) In considering the applicability of the fair value measurement for unquoted equity instruments as proposed in IFRS 9, in addition to TBG comments considered above, the IPSASB policy document, [Process for Reviewing and Modifying IASB Documents](#), has been followed. An analysis is provided in section C below.

Recommendation

4. TBG and staff agreed that there was no compelling argument to depart from the fair value measurement guidance for unquoted equity instruments prescribed in IFRS 9 and included in the ED. However, it was agreed that there is a need for additional guidance to be considered in assisting preparers with determining the fair value of such unquoted instruments (see discussions under point B below).

B. Should additional application guidance on fair value measurement be included on valuation techniques, for example, specifically permitting the use of the net asset value as a method of valuing unquoted equity instruments?

Detail

5. A TBG member noted that the application guidance on fair value in the ED (carried forward from IPSAS 29) requires significant judgment to determine the appropriate valuation methodology and to develop estimates of fair value. This could leave the same instrument being valued using different methodologies by different entities which reduces comparability.
6. Other TBG members noted that IFRS 9 was issued subsequent to IFRS 13. IFRS 13 includes extensive guidance on the determination of fair value. The IASB has also issued educational material on IFRS 13 to demonstrate the assist in understanding how to assess fair value.
7. Currently there is not an IPSAS equivalent to IFRS 13 which raises challenges to preparers in determining the appropriate valuation techniques applicable in determining fair value of unquoted equity instruments.
8. TBG members proposed that additional application guidance, basis for conclusions, or implementation guidance be developed to indicate specific valuation techniques to be applied, such as the use of net asset value, to help preparers with applying the measurement requirements in the ED.
9. Staff acknowledges the application challenges noted and the need for judgment in applying the existing application guidance. It also notes that the flexibility of the authoritative guidance in the ED allows management to apply their expertise and judgment in selecting the appropriate valuation techniques (based on facts and circumstances of the transaction). Further, the ED

guidance is intended to be principle-based. There is a risk of providing guidance that is too prescriptive and removes the ability for preparers to apply judgment.

10. By prescribing or indicating preferred valuation techniques in the authoritative guidance, the IPSASB may be exposed to:
 - (a) Unintentionally implying that certain valuation techniques (e.g. net asset value) should be considered, or weighted more heavily than others, without consideration of any specific facts or circumstances;
 - (b) Unintentionally removing the onus on management to comprehensively assess facts and circumstances present to determine which valuation technique(s) may be the most applicable to the instrument in question. And instead, simply defaulting to valuation methodologies prescribed or listed in the Standard even though they may not provide the most relevant information;
 - (c) Unintentionally removing the need for entities to involve valuation professionals when appropriate (when transactions are complex); and
 - (d) Introducing a departure from IFRS without a compelling public sector reason. Determining fair value for similar investments in unquoted equity instruments is also a challenge in the private sector.
11. In practice, diversity in valuation methodology may exist when new financial products/structure are introduced. However, valuation methodologies for specific types of instruments develop and are consistently applied over time (e.g. use of bond yields, earnings multiples, discounted cash flows...etc.). This generally results in a high level of comparability and consistency among reporting entities.
12. A project on public sector measurement is on the IPSASB's agenda and is scheduled to start up by early 2017. This project will undertake a full assessment of the measurement requirements in IPSASs and is expected to consider the valuation methodologies applicable in determining current value. Additional authoritative guidance on fair value not included in IPSAS 29 or the provisions in IFRS 9 would be more appropriately developed in the scope of the public sector measurement project.

Recommendation

13. Staff and the TBG agreed that specific public sector illustrative examples and implementation guidance should be developed to demonstrate how certain valuation techniques may be applied in valuing unquoted equity instruments in the public sector. The IASB's education material on illustrative examples to accompany IFRS 13 will be used as a source of reference in developing these examples.

C. Analysis of Process for Reviewing and Modifying IASB Documents

Detail

14. In assessing the applicability of fair value measurement to unquoted equity instruments, besides considerations raised by the TBG as noted in section A, the IPSASB's policy paper [Process for Reviewing and Modifying IASB Documents](#), has been considered as follows.
15. The IPSASB's policy paper requires an assessment on whether public sector issues warrant a departure from the proposed IASB requirements. This assessment includes:
 - (a) Whether applying the requirements of the IASB document would mean that the objectives of public sector financial reporting would not be adequately met;

- (b) Whether applying the requirements of the IASB document would mean that the qualitative characteristics of public sector financial reporting would not be adequately met; and,
- (c) Whether applying the requirements of the IASB document would require undue cost or effort.

Objectives of public sector financial reporting

16. According to paragraph 2.1 of The Conceptual Framework for General Purpose Financial Reporting By Public Sector Entities, the objectives of financial reporting are “to provide information about the entity that is useful to users of GPFRs for accountability purposes and for decision-making purposes”.
17. Staff is of the view that the classification of investments in unquoted equity investments in accordance with the new IFRS 9 classification to be accounted for at fair value through surplus or deficit or as fair value through net assets/equity meets the objectives of public sector financial reporting because:
 - (a) It enhances the accountability in regards to changes in value of the financial investments in equity instruments and faithfully represents the information on the financial capacity such investments provide the entity; and,
 - (b) It enhances decision-making in regards to such investments, as it provides relevant information to inform management of these investments.

Qualitative characteristics of public sector financial reporting

18. Staff is of the view that the proposals in the ED related to accounting for financial investments in unquoted equity investments would benefit the following qualitative characteristics (QC):
 - (a) Understandability – because the estimated fair value of the financial assets (unquoted equity investments) are reflected in the statement of financial position at each reporting period with the changes in value reflected in the statement of financial performance (when classified as fair value through surplus or deficit) or in the statement of net assets / equity (when classified as fair value through net assets / equity when irrevocable election is made for certain investments). From the perspective of the user, information on the current value of the investment is understandable.
 - (b) Comparability – the change in the requirement to require fair value measurement for all equity investments increases the comparability with other entities and with other financial assets carried at fair value;
 - (c) Faithful representation – allows a more faithful representation of the financial effect of investing in unquoted equity instruments;
 - (d) Relevance – provides more relevant information for decision-making and accountability purposes.
 - (e) Verifiability – The proposed guidance lays out principles to be applied in using judgment to estimate the fair value of unquoted equity instruments. The Conceptual Framework notes that verifiability is the quality of information that helps ensure that information faithfully represents the economics it purports to represent. It acknowledges that different knowledgeable and independent observers could reach general consensus, although does not require complete agreement. The Framework further notes that the estimate need not be a single point, and can be a range. The guidance proposed is consistent with the QC of variability and provides the appropriate considerations for developing an estimate of fair

value and in making judgments in the context of an unquoted equity investment. When considering cost as an alternative, the fair value requirements satisfy the QC of verifiability and provide a more faithful representation of the economic value of an investment in unquoted equity instruments.

- (f) **Timeliness** – The proposed guidance meets the QC of timeliness as it requires updates at each reporting period. Compared to a cost basis for measuring an investment in an unquoted equity instrument, the fair value requirement appears to better reflect the QC of timeliness.

Undue cost or effort in applying the requirements of the IASB

- 19. Staff did not identify any undue cost or effort in considering the change from the requirements for accounting for unquoted equity investments under IPSAS 29 and IFRS 9. This is because under both approaches there is a requirement to consider fair value measurement. Meaning that even if the entity determines that a cost approach is most applicable under IPSAS 29, it would first have to demonstrate that there is not a reasonable range of fair values and therefore fair value should be precluded and cost used. Under IFRS 9, there is a presumption that a fair value can be estimated, only after that presumption is rebutted, can cost be used as a basis. In either case, there would need to be an exercise to attempt to estimate the fair value of the investment before concluding that a cost basis is appropriate. Therefore, staff is of the view that the requirements in IFRS 9 do not require significant undue cost or effort.

Recommendation

- 20. Based on the guidance in the document *Process for Reviewing and Modifying IASB Documents* and the IPSASB Conceptual Framework guidance and the staff analysis above, a departure from the requirement to measure financial assets in unquoted equity instruments at fair value is not proposed.

Appendix D: ED Development—Unquoted Equity Instruments Arising from Non-Exchange Transactions

Detail

1. A Task Based Group (TBG) member noted that in the public sector, equity instruments are sometimes obtained with minimal cash flow expectations as a way of providing funding or a subsidy to another public sector entity. The entity expects to receive nil or minimal cash flows from the investment at inception. Therefore, the consideration provided is significantly above the fair value of the instrument and the transaction appears similar in nature to a concessionary loan.
2. IPSAS 29 provides specific public sector guidance on concessionary loans. However, the Standard is silent on transactions involving equity instruments with “concessionary terms”. The TBG member suggested that additional guidance equivalent to existing guidance on concessionary loans should be developed for such investments.
3. Staff acknowledges the prevalence of such transactions in the public sector. However, staff has reservations on developing additional guidance on “concessionary equity instruments” because of fundamental differences in the economics between equity and debt instruments, summarized as follows:

	Debt	Equity
Contractual Cash Flows	<p>Fixed and determinable cash flows</p> <p>A debt instrument (such as a concessionary loan) has contractual cash flows with fixed and determinable payments of principle and interest, with terms set by contract at inception.</p> <p>The ability to determine with certainty at inception, returns over the life cycle of the instrument, supports the concept of “concessionary terms”. In other words, the investor can identify objectively terms of the agreement that are “concessionary”, because if he/she chooses to invest the funds in an alternative fixed income instrument in an arms-length exchange transaction, the investor will be contractually guaranteed to receive a determinable amount of incremental cash flow compared to the “concessionary terms”.</p>	<p>Variable cash flows with unlimited upside/downside</p> <p>An equity instrument may or may not have dividend terms. Furthermore, dividends can be deferred and non-cumulative even when such terms exist. An equity instrument provides a legal claim on a pro-rata share of the entity’s net assets. Therefore, the cash flows (i.e. returns) of an equity instrument are variable and unpredictable.</p> <p>The nature of equity instruments, with unlimited upside and downside in returns, raises the question of whether equity instruments can have determinable “concessionary” terms at inception. Compared to a debt instrument, an investor may not be able to easily identify the “concessionary” term of an equity instrument, because if he/she invest the same amount of funds in an alternative equity instrument in an arms-length exchange transaction, there is no certainty to the investor receiving more cash flow compared to the “concessionary” equity instrument given the unpredictable nature of variable returns which for any instrument, could be nil in a bankruptcy dissolution.</p>
Market Terms	<p>Easily defined “market terms”</p> <p>Debt instruments typically transact at standard market terms which are primarily a function of:</p> <ul style="list-style-type: none"> i) prevailing interest rates (i.e. the risk free rate); and ii) credit quality of the issuer. <p>The wide use of industry recognized credit rating agencies (e.g. S&P, Moody’s...etc.), further introduces transparency and standardization of such information, and helps to develop general market consensus</p>	<p>Challenging to define “market terms”</p> <p>The price that equity instruments transact at reflects a wide range of factors such as:</p> <ul style="list-style-type: none"> • Dividend terms, voting rights, and various other rights, options, and warrants attached to the shares; • Earnings forecast and growth potential of issuer; • Capital structure, liquidity, and credit quality of issuer; • Outlook for the industry the issuer operates in; • A wide range of macro-economic conditions (e.g. commodity prices, employment rates ...etc.)

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	on the appropriate risk premium associated with a credit rating. This two-dimensional structure and verifiability of the “market terms” of a debt instrument, makes the identification of “below market terms” and defining such terms as “concessionary” reasonably straight forward.	<ul style="list-style-type: none"> Investor specific considerations (see below) Information asymmetry and irrational behaviour of investors <p>Volatility observed in equity markets is a reflection of the complexity of the large number of factors that drive equity value, compared to the fixed income securities that are much less volatile and respond primarily to interest rates. As a result, especially in the case of unquoted equity instruments, defining what is a “below market term” (i.e. concessionary term) becomes a challenge.</p>
Premiums and Discounts	<p>Generally transact based on market terms</p> <p>Given that the investor’s involvement with the issuer of a debt instrument is generally limited to receiving contractual principle and interest payments, debt agreements are generally entered into at “market terms” (as discussed above). Any purchase premiums or discounts would solely relate to the contractual terms of debt instrument compared to market interest rates. Therefore any difference between the cash consideration paid or received, compared to such “market terms” can be viewed and defined as “concessionary”, which is reflected in existing guidance in IPSAS 29.</p>	<p>May transact at entity specific transaction price</p> <p>Equity instrument, through voting rights, allow the investor to influence operations of the investee. Further, the legal entitlement to a pro-rata share of the net assets of the investee provides incentive for other types of relationships and interactions between the investor and investee. It is not uncommon for entities to pay a premium (or discount) for certain equity investments to reflect entity specific considerations, examples of which could include:</p> <ul style="list-style-type: none"> entity pays a purchase premium for entity specific synergy expectations from an strategic alliance; start-up enterprise offers equity at a discount, to a venture capitalist who can also bring expertise to the operations of the business; service provider entity offers equity at a discount to a another entity, to become sole distributor of a service in a particular jurisdiction <p>As demonstrated above, consideration can be above or below “market value” for equity investments for various strategic reasons that are not “concessionary” in nature. As a result, defining any “non-market terms” broadly as “concessionary” does not seem appropriate.</p>

- Staff does not support including guidance in the ED for equity instruments with concessionary terms that mirrors existing concessionary loan guidance, because of the differences in the nature of debt versus equity instruments. However, staff acknowledges the concerns raised by the TBG member and developed three alternative proposals for the IPSASB to consider.

Proposals

Proposal A

- When equity instruments arise from a non-exchange transaction, an entity should first review the transaction to identify the presence of a grant, and if applicable, account for it in accordance with IPSAS 23. The existing recognition and measurement guidance in the ED sufficiently addresses the recognition and measurement of any equity instruments (after assessing and separately recognizing any grant portions of the transaction) that are in scope of this ED.
- The following application guidance is developed for consideration, and is currently reflected in the [draft ED](#):

Equity Instruments Arising from Non-Exchange Transactions

- AG 116 *In the public sector, equity investment can be used as a way for an entity to provide financing or subsidized funding to another public sector entity. In such a transaction, there is generally a lack of an active market for such investments (i.e. the equity instrument is unquoted), and there are no or minimal future cash flow expectations from the investment besides a potential redemption by the issuing entity. Cash is provided by the investing entity to the investee generally to further the investee's economic or social objectives. Examples of such investments could include membership shares in a development bank, or equity investment in another public sector entity that provides certain social programs or services (e.g. shelters, subsidized housing, small business assistance...etc.)*
- AG 117 *At initial recognition of such transactions, an entity shall analyze the substance of the arrangement and assess whether the cash provided in full or in part, is in substance a grant, with the intention at the outset being provision or receipt of resources by way of a non-exchange transaction. To the extent that the transaction is a non-exchange transaction, any assets or revenues arising from the transaction are accounted for in accordance with IPSAS 23. The entity providing the grant shall recognize the amount as an expense in surplus or deficit at initial recognition.*
- AG 118 *To the extent an equity instrument arises from the transaction that is within the scope of this [draft] Standard, it is to be recognized initially at fair value in accordance with paragraph 56. The equity instrument is to be measured subsequently in accordance with paragraphs 58-60. If the instrument does not have an active market, the entity shall consider valuation techniques and inputs in [AG 136- AG 143](#)) in determining its fair value.*

7. The main advantages of this approach include:
 - (a) Addresses the TBG's concern and acknowledges the IPSASB's consideration for such transactions in the public sector; and
 - (b) Provides the sequence of analysis to be undertaken (i.e. first identifying and accounting for any grants, then accounting for the financial instrument) without prescribing the determination of the non-exchange component, and therefore allows judgment to be applied based on facts and circumstances of the transaction.
8. The main disadvantages of this approach include:
 - (a) Guidance may not be very helpful for preparers, as it does not prescribe a specific definition, or "boundary" for the "concessionary" component vs. the financial instrument; and
 - (b) It is debatable, as noted in the comparison of equity and debt instruments in paragraph 3 above, whether the concept of a "concessionary" equity instrument exists.

Proposal B

9. The objective of this proposal is to provide guidance that mirrors the concessionary loan guidance and help preparers in distinguishing the non-exchange component of the transaction from the financial instrument.
10. The application guidance proposed under this approach is as follows:

Equity Instruments Arising from Non-Exchange Transactions

AG XX In the public sector, equity investment can be used as a way for an entity to provide financing or subsidized funding to another public sector entity. In such a transaction, there is generally a lack of an active market for such investments (i.e. the equity instrument is unquoted), and there are no or minimal future cash flow expectations from the investment besides a potential redemption by the issuing entity. Cash is provided by the investing entity to the investee generally to further the investee's economic or social objectives. Examples of such investments could include membership shares in a development bank, or equity investment in another public sector entity that provides certain social programs or services (e.g. shelters, subsidized housing, small business assistance...etc.)

AG XX The intention of such equity instruments at the outset is to provide or receive resources at below market terms. As such, the transaction price on initial recognition of the equity instrument may not be its fair value. At initial recognition, an entity therefore analyzes the substance of the equity issued or received into its component parts, and accounts for those components using the principles in paragraphs AGXX and AGXX below.

AG XX An entity firstly assesses whether the substance of such a transaction is in fact an equity investment, a grant, or a combination thereof, by applying the principles in IPSAS 28 and paragraphs 42–58 of IPSAS 23. If an entity has determined that the transaction, or part of the transaction, is an equity investment, it assesses whether the transaction price represents the fair value of the equity on initial recognition. An entity determines the fair value of the equity by using the principles in [AG131–AG132](#). Where an entity cannot determine fair value by reference to an active market, it uses a valuation technique ([AG136-143](#)).

AGXX. Any difference between the fair value of the equity and the transaction price (the equity proceeds) is treated as follows:

- (a) Where the equity is received by an entity, the difference is accounted for in accordance with IPSAS 23.*
- (b) Where the equity is granted by an entity, the difference is treated as an expense in surplus or deficit at initial recognition.*

Illustrative Examples are provided IEXX to IEXX accompanying this [draft] Standard.

AG114. After initial recognition, an entity subsequently measures equity instruments in accordance with paragraphs [58–60](#).

11. The main advantages of this approach include:

- (a) The proposal explicitly addresses the concern raised by the TBG, and the guidance proposed is consistent with existing guidance on concessionary loans; and
- (b) Compared to Proposal A, this prescriptive guidance could be more helpful to preparers in specifically identifying and measuring the non-exchange element.

12. The main disadvantages of this approach include:

- (a) While this prescribes a “boundary” to define the non-exchange element which may be perceived as more helpful to preparers, there may still be significant challenges for preparers in identifying what a “below-market term” is for an unquoted equity instrument;
- (b) This approach requires any consideration over and above the entity determined fair value, to be accounted for as “concessionary” or the non-exchange component. This eliminates the concept of payment of any premiums or discounts on equity instruments for non-concessionary reasons, such as to achieve certain strategic objectives, which often exist in practice;
- (c) This may ultimately result in requiring all unquoted equity instruments to be assessed through this analysis, which may add undue costs and effort to preparers; and
- (d) It is debatable, as noted in the comparison in paragraph 3 above, whether the concept of a “concessionary” equity instrument exists.

Proposal C

13. The third alternative proposed is to not add any additional application guidance, as consistent with the approach taken under IPSAS 29. The primary arguments for this proposal are:

- (a) Due to the non-predictive nature of equity returns as described in paragraph 3 above, equity cannot be defined as “concessionary” in a similar manner to “concessionary loans”;
- (b) Although the investee does not anticipate any cash flows in the future from the equity instrument, the entity is legally entitled to a pro-rata share of the investee’s net assets upon dissolution. The consideration paid is therefore a reflection of this contractual right to future economic value; and
- (c) The ED requires equity instruments to be measured at fair value, any consideration in excess of fair value to be recognized in surplus/deficit upon initial recognition. If there is a component of consideration paid above what the entity determines to be the fair value of the equity, it is accounted for in accordance with this provision (i.e. no distinction is made between a “concessionary” over-payment and a premium paid for strategic or other reasons).

Recommendation

14. Staff’s view is that the existing requirement in the proposed ED combined with existing guidance on non-exchange transactions in IPSAS 23 sufficiently addresses such transaction involving equity instrument. This is because of:

- The inherent variability in equity returns;
- The practical challenge in identifying non-market terms on unquoted equity instruments;
- The prevalence of purchase premiums and discounts on equity instruments that are non-concessionary in nature; and
- The risks with defining non-market terms as “concessionary” for equity instruments as noted in the analysis above.

15. As a result, staff recommends Proposal C (no additional guidance proposed).

Appendix E: ED Development—Expected Credit Loss Impairment Model

Detail

1. 1. IFRS 9 introduces a forward-looking expected credit loss (ECL) impairment model which is proposed in the ED. Compared to the existing incurred loss impairment model under IPSAS 29, the ECL was developed to respond to the criticism of delayed recognition of impairment losses inherent in the incurred loss model. The model is described in more detail in [Issues Paper 5.2.8](#).

Analysis—Process for Reviewing and Modifying IASB Documents

1. The IPSASB's policy paper requires an assessment on whether public sector issues warrant a departure from the proposed IASB requirements. This assessment includes:
 - (a) Whether applying the requirements of the IASB document would mean that the objectives of public sector financial reporting would not be adequately met;
 - (b) Whether applying the requirements of the IASB document would mean that the qualitative characteristics of public sector financial reporting would not be adequately met; and,
 - (c) Whether applying the requirements of the IASB document would require undue cost or effort.

Objectives of public sector financial reporting

2. According to paragraph 2.1 of The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities, the objectives of financial reporting are "to provide information about the entity that is useful to users of GPFRs for accountability purposes and for decision-making purposes".
3. Staff is of the view that the expected loss impairment requirements included in the ED meet the objectives of public sector financial reporting because:
 - (a) It enhances accountability because it holds managements accountable for its investment decisions by requiring the credit quality of a financial instrument, and the entity's best estimate of its impact on future cash flows to be reflected immediately in the instrument's carrying value at any point in time,
 - (b) It enhances decision-making in regards to such investments, as management of financial assets in a manner consistent with the economic value relevant information to inform management of these investments.

Qualitative characteristics of public sector financial reporting

4. Staff is of the view that the proposals in the ED related to the expected loss impairment model would benefit the following qualitative characteristics (QC) (compared to the existing incurred loss model included in IPSAS 29):
 - (a) Understandability – The expected loss impairment value is meant to provide a closer estimate of the economic value of financial assets. This provides users with a better representation of the financial capacity of the financial asset at each reporting period compared to the incurred loss model, which requires an objective indicator of impairment prior to recognizing any impairment losses.

- (b) Comparability – The proposed expected loss impairment model differentiates between instruments that have experienced a significant increase in credit risk and those that have not, thus improving the comparability of instruments based on their credit quality;
- (c) Faithful representation – allows a more faithful representation of the economic value of financial assets held by an entity;
- (d) Relevance – provides more relevant information for decision-making and accountability purposes, as the forward looking impairment model is more indicative of the expected future cash flows from the instrument, and more closely aligns with the economic value of the financial assets held.
- (e) Verifiability – The proposed guidance meets the qualitative characteristic of verifiability because it requires impairment estimates to be based on reasonable and supportable information, and requires monitoring of credit risk throughout the instrument's lifecycle compared to inception, which serves as a verifiable benchmark to determine the change.
- (f) Timeliness – The proposed guidance meets the QC of timeliness as the expected loss model requires an estimation and recognition of expected impairment from inception, which is continuously updated to reflect the credit worthiness of the financial assets. This should result in impairment being recognized more in line with when the impairment occurs economically. Compared to the incurred loss model which resulted in delayed recognition of impairments, this information is reflected on a more timely basis under the new model.

Undue cost or effort in applying the requirements of the IASB

5. The expected credit loss model for impairments of financial assets, can be very complex and resource intensive to initially set up and transition to. However, transactions relating to financial assets can be complex and also risky. Information on impairments of financial assets (recoverability of financial assets) can be seen as a key factor in the US financial crisis and the public sector sovereign debt issues seen in many areas of the world over the past few years. An impairment model, with the aim of better reflecting the true economics and recoverability of financial assets, justifies the cost and effort in application, and complexity of the principles. Furthermore, the standard acknowledges that the estimation of expected loss should be based on information that is available without undue cost or effort and does not require the entity to undertake an exhaustive search for any relevant information, nor does the standard require a complex modelling exercise. In addition, there are a number of practical simplifications available for simple financial assets, such as receivables, which many public sector entities would be able to apply (and for which most entities financial assets would be applicable). Therefore, staff is of the view that the expected loss model in IFRS 9 do not require significant undue cost or effort. .

Recommendation

6. Based on the guidance in the document Process for Reviewing and Modifying IASB Documents and the IPSASB Conceptual Framework and the staff analysis above, a departure from the expected loss impairment model principles is not proposed. The expected loss impairment model provides more relevant and timely information on financial assets which better reflects the true economics of the instrument. The assessment of impairment is thought to be similar in both the public and private sectors and the proposed principle should be carried forward in the ED.

Appendix F: Application of Expected Credit Loss Model to Receivables

1. In reviewing the impairment provisions in the ED, a member of the TBG had raised that the expected loss impairment model proposed can be complex and many public sector entities may have only receivables as financial assets.
2. The TBG member further indicated that some public sector entities may not have a choice in regards to the counterparties with which they transact, because they are mandated by laws and regulation to transact (e.g. hydro supplier, water utility). As such, credit risk information may not be available on an individual basis (e.g. student loan example). Forward-looking information may be challenging to obtain, complicating the application of the proposed impairment model

Loans and other debt instruments—Regular Impairment:

Detail

1. The proposals in the ED include practical and operational simplifications to make impairment assessments easier in practice (such as allowing the assessment of impairment on a portfolio rather than an individual instrument level based on information availability, simplifications for financial assets with low credit risk, change in 12 months risk of default as approximation for change in life time risk, and the 30 day past due rebuttable presumption noted below). For example, the credit risk for a student loan portfolio could be assessed on portfolio basis. Further, the 30 days past due rebuttable presumption can be applied to simplify the assessment by using historical past due information as a primary source of input in the impairment model
2. Staff further notes that private sector entities with mainly receivables face similar challenges as public sector entities, when assessing impairment on large diverse portfolios of loans to individuals (information on individual credit profiles not readily available or impractical to assess for credit risk deterioration at an instrument level).

Recommendation

3. Staff proposes that public sector specific illustrative examples be developed or adapted to help entities with the practical application of impairment assessments on a portfolio level when individual assessments are not possible or practical. Staff does not recommend any departures in the proposed standard text or application guidance, because the issue of assessing counterparties and large portfolios of receivables is one that is common in both the public and private sectors

Receivable—Estimating ECL and the Simplified Impairment Approach:

Detail

4. Expected credit loss (ECL) is required to be recognized at initial recognition of receivables by an entity. While ECL is a probability weighted estimate of credit losses, the ED does not prescribe a specific method for calculating impairments. The proposal explicitly notes complex calculations or modelling exercises may not be required: Existing loss provisioning mechanisms can be leveraged as a basis for determining ECL, subject to any qualitative assessments of current and forecasted conditions and adjustments as a result, if any. Specifically:
 - (a) ECL can be determined using historical credit loss experience for trade receivables with consideration for current and future conditions [\[ED AG 203–204\]](#). Use of a provision matrix is allowed, for example, 1% if not past due, 2% if less than 30 days past due, 3% if more than 30 days ...etc.) [\[ED AG 187\]](#).

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- (b) Determining the probability – weighted amount may not need to be a complex analysis (e.g. the average credit losses of a large group of financial instruments with shared risk characteristics may be a reasonable estimate of the probability-weighted amount) [ED [AG 194](#)].
 - (c) The best reasonable and supportable information could be the unadjusted historical information in some cases, depending on the nature of the historical information and when it was calculated, compared to circumstances at the reporting date and the characteristics of the financial instrument being considered [ED [AG 204](#)].
5. Staff notes that most receivables are short-term and have maturities of less than twelve months. In practice, due to their short-term nature, ECL on such receivables is not expected to be significantly different from loss allowances determined from the incurred loss model based on historical loss experience.
 6. Staff acknowledges however, that public sector entities may have more receivables that have longer maturities compared to the private sector. The simplified impairment model proposed would alleviate the administrative burden of tracking and interpreting credit risk information for such longer-duration receivables, which some consider the most onerous and challenging part of applying the expected credit loss model.
 7. Given the provisions noted above in the ED, determining the lifetime credit losses for receivables in practice would often be based on historical data and likely calculated off of existing impairment models with enhancements added. The public sector entity would be required to layer on qualitative assessments to identify current conditions and consideration of macroeconomic projections which may be significantly different from those that existed in the historical period captured to help determine if adjustments to the projections based on historical data are needed.
 8. The flexibility in requirements pertaining to measuring ECL combined with the proposed simplified approach to impairment for assessing expected credit losses on receivables should help preparers with a practical method of assessing impairment without undue cost or effort.

Recommendation

9. Staff proposes that illustrative examples be developed or adapted on public sector specific scenarios to assess expected credit losses for receivables. Staff does not recommend any departures in the standard text or application guidance, because staff believe that the simplified approach is appropriate for assessing receivables in a public sector context.
10. Staff also proposes a BC to outline the IPSASB's views on these issues:

"The IPSASB notes that for many public sector entities, receivables may be the only significant financial asset held. In addition, public sector entities may not have an ability to choose the counterparties they transact with because of the nature of services provided and laws or regulations requiring provision of services to all service recipients (for example, when a public utility provides water or hydro services). Under such scenarios credit risk information at an individual counterparty level and forward looking information/forecasts may not be available without undue cost or effort. The IPSASB considered whether public sector modifications or additional guidance should be included in the Standard and concluded that the simplified approach for receivables along with practical expedients available in determining expected credit losses provide appropriate relief to the practical challenges under such scenarios. The IPSASB further acknowledges that the Standard allows for historical data and existing models be incorporated in estimating expected credit losses under such circumstances with consideration for any adjustments as needed to reflect current and forecasted conditions as prescribed in the Standard."

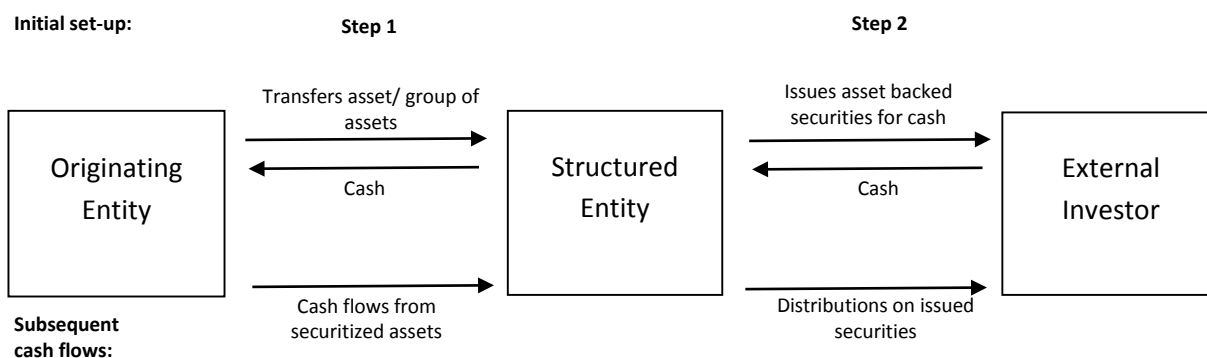
Appendix G: Securitizations of Rights Arising From Sovereign Powers

Detail

1. Securitizations in the public sector can be categorized into two types:
 - (a) Securitizations of recognized assets on the statement of financial position (e.g. tax receivables), similar to securitization schemes widely observed in the private sector.
 - (b) Securitizations of a sovereign right that relates to a future flow transaction (e.g. right to future taxation rights) which does not related to recognized asset on the balance sheet, because it does not meet the recognition criteria as it does not result from a past event.
2. The term "securitization" isn't explicitly defined under IFRS, but generally refers to the practice of pooling together assets and transforming them into a security by selling their related cash flows to third party investors.
3. The issue identified in the public sector securitization project was how to treat the transaction to sell the future-flows that relate to sovereign powers.

Financial instruments in Securitization Schemes

4. While securitization generally results in financial instruments being issued by a structured entity (e.g. asset backed securities) as demonstrated in Step 2 below, the first step in a securitization scheme is transferring assets from the entity to a securitization vehicle which constitutes a sale transaction. This step is in scope of the financial instruments guidance only to the extent of the asset being transferred/derecognized meets the definition of a financial asset.



Existing Guidance on Securitizations

5. The key accounting issues in securitization schemes are addressed with existing guidance as follows:

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		Existing Guidance	Type A Securitizations	Type B Securitizations
Step 1	Derecognition of the securitized assets, and recognition and measurement of any gain/loss from sale	IPSAS 29/ED	✓	No asset to derecognize. Day 1 gain?
	Recognition and measurement of continuing involvement, and any new financial liabilities arising from the structure	IPSAS 29/ED	✓	✓
Step 2	Recognition and measurement of new financial instruments issued	IPSAS 29/ED	✓	✓
Consolidation	Whether the originating entity controls the structured vehicle and therefore should consolidate the vehicle	IPSAS 35	✓	✓

Type A Securitizations of Recognized Assets

6. As shown above, sufficient existing guidance exists to address all aspects of Type A securitizations. No additional guidance has been identified as needed.

Type B Securitizations of Future Flows from Sovereign Rights

7. The key accounting difference that distinguishes Type A and Type B securitizations relates to the transfer of the asset/right to the structured entity in Step 1. In a future flow securitization (Type B), as the sovereign right does not constitute an asset in accordance with the Conceptual Framework, there is no financial asset (or asset whatsoever) to derecognize at the inception of the transaction. The question arising from the sale of a sovereign right is how to account for the consideration received, whether the recognition should result in a Day 1 gain or a deferral of revenue to be recognized over time. These issues however, are revenue recognition issues and not related to financial instruments accounting or requirements.
8. Staff notes that sufficient guidance exists in the ED as well as IPSAS 35 to cover all other steps in the securitization transaction for these future flows as noted above.

Recommendation

9. Staff's view is that the accounting for revenue recognition on sale of a sovereign right is beyond the scope of this ED given the lack of a financial instrument in the transaction. Staff recommends that the issue be considered in the IPSASB's revenue project.
10. A BC is proposed in the ED to acknowledge such securitization schemes and clarify that the sale of the sovereign powers is a revenue transaction rather than a financial instruments transaction, as proposed below:

"In the public sector, there are securitization schemes involving a sale of future flows arising from a sovereign right, such as right to taxation. The IPSASB considered whether public sector modifications or additional guidance is needed in the standard to address such transactions. The IPSASB decided because rights arising from sovereign powers relate to future events, the recognition criteria are not met and an asset is not recognized. Therefore the sale of future flows arising from rights is a revenue transaction that should be accounted for in accordance with the relevant revenue guidance. The IPSASB further concluded that sufficient guidance exists in the Standard to address recognition and measurement of any financial assets and liabilities arising from such transactions."

APPENDIX H: DRAFT ED — FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT⁷

Objective

1. The objective of this Standard is to establish principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows.

Scope

2. This Standard shall be applied by all entities to all types of financial instruments except:
 - (a) ~~Those interests in subsidiaries controlled entities~~, associates and joint ventures that are accounted for in accordance with ~~IFRS 10 Consolidated Financial Statements, IAS 27 IPSAS 34 Separate Financial Statements, IPSAS 35 Consolidated Financial Statements, or IAS 28 IPSAS 36 Investments in Associates and Joint Ventures~~. However, in some cases, ~~IPSAS 34, IFRS 10 IPSAS 35, IAS 27 or IAS 28 IPSAS 36~~ require or permit an entity to account for an interest in a ~~subsidiary controlled entity~~, associate or joint venture in accordance with some or all of the requirements of this Standard. Entities shall also apply this Standard to derivatives on an interest in a ~~controlled entity subsidiary~~, associate or joint venture unless the derivative meets the definition of an equity instrument of the entity in ~~IAS 32 IPSAS 28 Financial Instruments: Presentation~~.
 - (b) ~~Rights and obligations under leases to which IFRS 16 IPSAS 13 Leases applies~~. However:
 - (i) ~~F~~inance lease receivables (ie net investments in finance leases) and operating lease receivables ~~recognised~~~~recognized~~ by a lessor are subject to the derecognition and impairment requirements of this Standard;
 - (ii) ~~L~~ease liabilities ~~recognised~~~~recognized~~ by a lessee are subject to the derecognition requirements in paragraph 34~~3.3.4~~ of this Standard; and
 - (iii) ~~D~~erivatives that are embedded in leases are subject to the embedded derivatives requirements of this Standard. ~~[IFRS 9 Par. 2.1(b), IPSAS 29 Par. 2(a)]~~
 - (c) ~~E~~mployers' rights and obligations under employee benefit plans, to which ~~IAS 19 IPSAS 2539 Employee Benefits~~ applies. ~~[IFRS 9 Par. 2.1(c), IPSAS 29 Par. 2(c)]~~
 - (d) ~~F~~inancial instruments issued by the entity that meet the definition of an equity instrument in ~~IAS 32 IPSAS 28~~ (including options and warrants) or that are required to be classified as an equity instrument in accordance with paragraphs ~~16A-15~~ and ~~16B-16~~ or paragraphs ~~16C-17~~ and ~~16D-18~~ of ~~IPSAS 28 IAS 32~~. However, the holder of

⁷ This draft of the Exposure Draft on Financial Instruments: Recognition and Measurement only contains the core text and application guidance on the following sections: Objective, Scope, Recognition and derecognition, Classification, Measurement (including impairment) and Defined Terms. Hedge Accounting and Transition provisions are to be included in the draft ED in December.

such equity instruments shall apply this Standard to those instruments, unless they meet the exception in (a). ~~[IFRS 9 Par. 2.1(d), IPSAS 29 Par. 2(c)]~~

(e) ~~R~~ights and obligations arising under:

- (i) ~~(i) A~~an insurance contract, ~~as defined in IFRS 4 Insurance Contracts,~~ other than an issuer's rights and obligations arising under an insurance contract that meets the definition of a financial guarantee contract in Appendix A, or**
- (ii) ~~(ii) A~~a contract that is within the scope of ~~IFRS 4~~relevant international or national accounting standard dealing with insurance contracts because it contains a discretionary participation feature.**

~~However, this Standard applies to a derivative that is embedded in an insurance contract within the scope of IFRS 4 if the derivative is not itself an insurance contract (see paragraphs 46–52 and Appendix A paragraphs AG90–AG97 of this Standard) within the scope of IFRS 4. An entity applies this Standard to financial guarantee contracts, but shall apply the relevant international or national accounting standard dealing with insurance contracts if the issuer elects to apply that standard in recognizing and measuring them. Notwithstanding (i) above, an entity may apply this Standard to other insurance contracts which involve the transfer of financial risk. Moreover, if an issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting that is applicable to insurance contracts, the issuer may elect to apply either this Standard or IFRS 4 to such financial guarantee contracts (see paragraphs B2.5–B2.6). The issuer may make that election contract by contract, but the election for each contract is irrevocable.~~ ~~[IFRS 9 Par. 2.1(e), IPSAS 29 Par. 2(e)]~~

(e)(f) ~~A~~any forward contract between an acquirer and a selling shareholder to buy or sell an acquiree that will result in an business entity combination within the scope of IFRS 3 Business Combinations ~~to which IPSAS XX 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. ~~[IFRS 9 Par. 2.1(f), IPSAS 29 Par. 2(f)]~~

(f)(g) ~~L~~oan commitments other than those loan commitments described in paragraph 42.3. However, an issuer of loan commitments shall apply the impairment requirements of this Standard to loan commitments that are not otherwise within the scope of this Standard. Also, all loan commitments are subject to the derecognition requirements of this Standard. ~~[IFRS 9 Par. 2.1(g)]~~

(g)(h) ~~F~~inancial instruments, contracts and obligations under share-based payment transactions to which the relevant international or national accounting standard dealing with share based payment IFRS 2 Share-based Payment applies, except for contracts within the scope of paragraphs 52.4–82.7 of this Standard to which this Standard applies. ~~[IFRS 9 Par. 2.1(h), IPSAS 29 Par. 2(h)]~~

(h)(i) ~~R~~ights to payments to reimburse the entity for expenditure that it is required to make to settle a liability that it ~~recognise~~recognizes as a provision in accordance with IPSAS 19 Provisions, Contingent Liabilities and Contingent Assets~~IAS 37 Provisions, Contingent Liabilities and Contingent Assets~~, or for which, in an earlier period, it ~~recognised~~recognized a provision in accordance with IPSAS 19~~IAS 37~~. ~~[IFRS 9 Par. 2.1(i), IPSAS 29 Par. 2(i)]~~

- ~~(j)(i)~~ The initial recognition and initial measurement of rights and obligations arising from non-exchange revenue transactions within the scope of to which IPSAS 23 Revenue from Non-Exchange Transactions (Taxes and Transfers) applies. IFRS 15 Revenue from Contracts with Customers that are financial instruments, except for those that IFRS 15 specifies are accounted for in accordance with this Standard. [IFRS 9 Par. 2.1, IPSAS 29 Par. 2(j)]
- ~~(j)(k)~~ Rights and obligations under service concession arrangements to which IPSAS 32, Service Concession Assets: Grantor applies. However, financial liabilities recognized by a grantor under the financial liability model are subject to the derecognition provisions of this Standard (see paragraphs 34–37 and Appendix A paragraphs AG30–AG38). [no equivalent in IFRS 9 Par. IPSAS 29 Par. 2(k)]
3. The impairment requirements of this Standard shall be applied to those rights arising from that IFRS 15 IPSAS 9 and IPSAS 23 transactions which give rise to financial instruments specifies are accounted for in accordance with this Standard for the purposes of ~~recognising~~ recognizing impairment gains or losses. [IFRS 9 Par. 2.2, no equivalent paragraph under IPSAS 29]
 4. The following loan commitments are within the scope of this Standard:
 - (a) Loan commitments that the entity designates as financial liabilities at fair value through ~~profit or loss~~ surplus or deficit (see paragraph 454.2.2). An entity that has a past practice of selling the assets resulting from its loan commitments shortly after origination shall apply this Standard 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 44(d)4.2.1(d)). [IFRS 9 Par. 2.3, IPSAS 29 Par. 3]
 5. This Standard 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 Standard shall be applied to those contracts that an entity designates as measured at fair value through ~~profit or loss~~ surplus or deficit in accordance with paragraph 625. [IFRS Par. 2.4, IPSAS 29 Par. 4]
 6. 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 ~~profit or loss~~ 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~~recognizing that contract because it is excluded from the scope of this Standard (see paragraph 52.4). [IFRS Par. 2.5, no equivalent paragraph under IPSAS 29]

7. There are various ways in which a contract to buy or sell a non-financial item can be settled net in cash or another financial instrument or by exchanging financial instruments. These include:
 - (a) ~~w~~When the terms of the contract permit either party to settle it net in cash or another financial instrument or by exchanging financial instruments;
 - (b) ~~w~~When the ability to settle net in cash or another financial instrument, or by exchanging financial instruments, is not explicit in the terms of the contract, but the entity has a practice of settling similar contracts net in cash or another financial instrument or by exchanging financial instruments (whether with the counterparty, by entering into offsetting contracts or by selling the contract before its exercise or lapse);
 - (c) W~~w~~hen, for similar contracts, the entity has a practice of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin; and
 - (d) ~~when~~When the non-financial item that is the subject of the contract is readily convertible to cash.

A contract to which (b) or (c) applies is not entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements and, accordingly, is within the scope of this Standard. Other contracts to which paragraph 52.4 applies are evaluated to determine whether they were entered into and continue to be held for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements and, accordingly, whether they are within the scope of this Standard. [IFRS 9 Par. 2.6, IPSAS 29 Par. 5]

8. A written option to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, in accordance with paragraph 7(a)~~2.6(a)~~ or 2(d)~~2.6(d)~~ is within the scope of this Standard. Such a contract cannot be entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements. [IFRS 9 Par. 2.7, IPSAS 29 Par. 6]

Recognition and derecognition

Initial recognition

9. An entity shall ~~recognise~~recognize a financial asset or a financial liability in its statement of financial position when, and only when, the entity becomes party to the contractual provisions of the instrument (see paragraphs AG7~~B3.1.1~~ and AG8~~B3.1.2~~). When an entity first ~~recognise~~recognizes a financial asset, it shall classify it in accordance with paragraphs 38~~4.1.1~~–43~~4.1.5~~ and measure it in accordance with paragraphs 56~~5.1.1~~–57~~5.1.3~~. When an entity first ~~recognise~~recognizes a financial liability, it shall classify it in accordance with paragraphs 44~~4.2.1~~ and 45~~4.2.2~~ and measure it in accordance with paragraph 56~~5.1.1~~. [IFRS 9 Par. 3.1.1, IPSAS 29 Par. 16]

Regular way purchase or sale of financial assets

10. A regular way purchase or sale of financial assets shall be ~~recognised~~recognized and ~~derecognised~~derecognized, as applicable, using trade date accounting or settlement date accounting (see paragraphs AG9~~B3.1.3~~–AG12~~B3.1.6~~). [IFRS 9 Par. 3.1.2, IPSAS 29 Par. 40.]

Derecognition of financial assets

11. In consolidated financial statements, paragraphs ~~123.2.2–193.2.9~~, AG7~~B3.1.1~~, AG8~~B3.1.2~~ and AG13~~B3.2.1–AG29B3.2.17~~ are applied at a consolidated level. Hence, an entity first consolidates all subsidiaries-controlled entities in accordance with ~~IFRS 10~~IPSAS 35 and then applies those paragraphs to the resulting group-economic entity. [IFRS 9 Par. 3.2.1, IPSAS 29 Par. 17]
12. Before evaluating whether, and to what extent, derecognition is appropriate under paragraphs ~~133.2.3–193.2.9~~, an entity determines 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 ~~133.2.3–193.2.9~~ 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 ~~133.2.3–193.2.9~~ are applied to the interest cash flows.
 - (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 per cent share of all cash flows of a debt instrument, paragraphs ~~133.2.3–193.2.9~~ are applied to 90 per cent 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.
 - (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 per cent share of interest cash flows from a financial asset, paragraphs ~~133.2.3–193.2.9~~ are applied to 90 per cent 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 ~~133.2.3–193.2.9~~ 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 per cent of cash collections from a financial asset (or a group of financial assets), or (ii) the rights to 90 per cent of the cash flows from a group of receivables, but provides a guarantee to compensate the buyer for any credit losses up to 8 per cent of the principal amount of the receivables, paragraphs ~~133.2.3–193.2.9~~ are applied to the financial asset (or a group of similar financial assets) in its entirety.

In paragraphs ~~133.2.3–223.2.12~~, 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. [IFRS 9 Par. 3.2.2, IPSAS 29 Par. 18]

13. An entity shall ~~derecognise~~recognize 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 ~~143.2.4~~ and ~~153.2.5~~ and the transfer qualifies for derecognition in accordance with paragraph ~~163.2.6~~.

(See paragraph ~~103.1.2~~ for regular way sales of financial assets.) [IFRS 9 Par. 3.2.3, IPSAS 29 Par. 19]
14. An entity transfers a financial asset if, and only if, it either:
 - (a) ~~transfers~~ 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 ~~153.2.5~~. [IFRS 9 Par. 3.2.4, IPSAS 29 Par. 20]
15. 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 IPSAS 2, Cash Flow Statements~~IAS 7 Statement of Cash Flows~~) 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. [IFRS 9 Par. 3.2.5, IPSAS 29 Par. 21]
16. When an entity transfers a financial asset (see paragraph ~~143.2.4~~), it shall evaluate the extent to which it retains the risks and rewards of ownership of the financial asset. In this case:
 - (a) ~~if~~ If the entity transfers substantially all the risks and rewards of ownership of the financial asset, the entity shall ~~derecognise~~recognize the financial asset and ~~recognise~~recognize 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 shall continue to ~~recognise~~recognize the financial asset.
 - (c) ~~if~~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~~If the entity has not retained control, it shall ~~derecognise~~derecognize the financial asset and ~~recognise~~recognize separately as assets or liabilities any rights and obligations created or retained in the transfer.
 - (ii) ~~if~~If the entity has retained control, it shall continue to ~~recognise~~recognize the financial asset to the extent of its continuing involvement in the financial asset (see paragraph 26~~3.2.16~~). [IFRS 9 Par. 3.2.6, IPSAS 29 Par. 22]
17. The transfer of risks and rewards (see paragraph 16~~3.2.6~~) is evaluated by comparing the entity's exposure, before and after the transfer, with the variability in the amounts and timing of the net cash flows of the transferred asset. An entity has retained substantially all the risks and rewards of ownership of a financial asset if its exposure to the variability in the present value of the future net cash flows from the financial asset does not change significantly as a result of the transfer (eg because the entity has sold a financial asset subject to an agreement to buy it back at a fixed price or the sale price plus a lender's return). An entity has transferred substantially all the risks and rewards of ownership of a financial asset if its exposure to such variability is no longer significant in relation to the total variability in the present value of the future net cash flows associated with the financial asset (e.g., because the entity has sold a financial asset subject only to an option to buy it back at its *fair value* at the time of repurchase or has transferred a fully proportionate share of the cash flows from a larger financial asset in an arrangement, such as a loan sub-participation, that meets the conditions in paragraph 15~~3.2.5~~). [IFRS 9 Par. 3.2.7, IPSAS 29 Par. 23]
18. Often it will be obvious whether the entity has transferred or retained substantially all risks and rewards of ownership and there will be no need to perform any computations. In other cases, it will be necessary to compute and compare the entity's exposure to the variability in the present value of the future net cash flows before and after the transfer. The computation and comparison are made using as the discount rate an appropriate current market interest rate. All reasonably possible variability in net cash flows is considered, with greater weight being given to those outcomes that are more likely to occur. [IFRS 9 Par. 3.2.8, IPSAS 29 Par. 24]
19. Whether the entity has retained control (see paragraph 16(c)~~3.2.6(c)~~) of the transferred asset depends on the transferee's ability to sell the asset. If the transferee has the practical ability to sell the asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without needing to impose additional restrictions on the transfer, the entity has not retained control. In all other cases, the entity has retained control. [IFRS 9 Par. 3.2.9, IPSAS 29 Par. 25]

Transfers that qualify for derecognition

20. 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~~recognize 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~~recognized 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~~recognized

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 233.2.13. [IFRS 9 Par. 3.2.10, IPSAS 29 Par. 26]

21. If, as a result of a transfer, a financial asset is ~~derecognised~~derecognized 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~~recognize the new financial asset, financial liability or servicing liability at fair value. [IFRS 9 Par. 3.2.11, IPSAS 29 Par. 27]
22. On derecognition of a financial asset in its entirety, the difference between:
 - (a) ~~T~~the carrying amount (measured at the date of derecognition); and
 - (b) ~~T~~the consideration received (including any new asset obtained less any new liability assumed).

~~shall~~Shall be ~~recognised~~recognized in ~~profit or loss~~surplus or deficit [IFRS 9 Par. 3.2.12, IPSAS 29 Par. 27]
23. 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 12(a)(i)~~3.2.2(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~~recognized and the part that is ~~derecognised~~derecognized, 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~~recognized. The difference between:
 - (a) ~~the~~The carrying amount (measured at the date of derecognition) allocated to the part ~~derecognised~~derecognized; and
 - (b) ~~the~~The consideration received for the part ~~derecognised~~derecognized (including any new asset obtained less any new liability assumed).

~~S~~shall be ~~recognised~~recognized in ~~profit or loss~~surplus or deficit. [IFRS 9 Par. 3.2.13, IPSAS 29 Par. 28]
24. When an entity allocates the previous carrying amount of a larger financial asset between the part that continues to be ~~recognised~~recognized and the part that is ~~derecognised~~derecognized, the fair value of the part that continues to be ~~recognised~~recognized needs to be measured. When the entity has a history of selling parts similar to the part that continues to be ~~recognised~~recognized 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~~recognized, 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~~derecognized. [IFRS 3.2.14, IPSAS 29 Par. 30]

Transfers that do not qualify for derecognition

25. 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~~recognize the transferred asset in its entirety and shall ~~recognise~~recognize a financial liability for the consideration received. In subsequent periods, the entity shall

~~recognise~~recognize any ~~income~~revenue on the transferred asset and any expense incurred on the financial liability. [IFRS 9 Par. 3.2.15, IPSAS 29 Par. 31]

Continuing involvement in transferred assets

26. 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~~recognize 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 the 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 (see paragraph AG25~~B3.2.13~~).
 - (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. [IFRS 9 Par. 3.2.16, IPSAS 29 Par. 32]
27. When an entity continues to ~~recognise~~recognize an asset to the extent of its continuing involvement, the entity also ~~recognise~~recognizes an associated liability. Despite the other measurement requirements in this Standard, 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~~amortized cost of the rights and obligations retained by the entity, if the transferred asset is measured at ~~amortised~~amortized cost, or
 - (b) E~~e~~qual 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. [IFRS 9 Par. 3.2.17, IPSAS 29 Par.33]
28. The entity shall continue to ~~recognise~~recognize any ~~income~~revenue arising on the transferred asset to the extent of its continuing involvement and shall ~~recognise~~recognize any expense incurred on the associated liability. [IFRS 9 Par. 3.2.18, IPSAS 29 Par.34]
29. For the purpose of subsequent measurement, ~~recognised~~recognized changes in the fair value of the transferred asset and the associated liability are accounted for consistently with each other in accordance with paragraph 97~~5.7.1~~, and shall not be offset. [IFRS 9 Par. 3.2.19, IPSAS 29 Par.35]
30. 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~~recognize under continuing involvement, and the part it no longer ~~recognise~~recognizes on the basis of the relative fair values of those parts on the date of the transfer. For this purpose, the requirements of paragraph 24~~3.2.14~~ apply. The difference between:

(a) ~~€~~The carrying amount (measured at the date of derecognition) allocated to the part that is no longer ~~recognised~~recognized; and

(b) ~~€~~The consideration received for the part no longer ~~recognised~~recognized~~recognized~~.

Shall be ~~recognised~~recognized in ~~profit or loss~~surplus or deficit. [IFRS 9 Par. 3.2.20, IPSAS 29 Par. 36]

31. If the transferred asset is measured at ~~amortised~~amortized cost, the option in this Standard to designate a financial liability as at fair value through ~~profit or loss~~surplus or deficit is not applicable to the associated liability. [IFRS 9 Par. 3.2.21, IPSAS 29 Par. 37]

All transfers

32. If a transferred asset continues to be ~~recognised~~recognized, the asset and the associated liability shall not be offset. Similarly, the entity shall not offset any ~~income~~revenue arising from the transferred asset with any expense incurred on the associated liability (see paragraph 42~~47~~ of ~~IAS 32~~ IPSAS 28). [IFRS 9 Par. 3.2.22, IPSAS 29 Par. 39]

33. 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~~recognize 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~~derecognize the collateral, and the transferee shall ~~recognise~~recognize the collateral as its asset initially measured at fair value or, if it has already sold the collateral, ~~derecognise~~derecognize its obligation to return the collateral.

(d) Except as provided in (c), the transferor shall continue to carry the collateral as its asset, and the transferee shall not ~~recognise~~recognize the collateral as an asset. [IFRS 9 Par. 3.2.23, IPSAS 29 Par. 39]

Derecognition of financial liabilities

34. 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, ~~or~~ cancelled or expires. [IFRS 9 Par. 3.3.1, IPSAS 29 Par. 41]

35. 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. [IFRS 9 Par. 3.3.2, IPSAS 29 Par. 42]
36. 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~~recognized in ~~profit or loss~~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 IPSAS 23. [IFRS 9 Par. 3.3.3, IPSAS 29 Par. 43]
37. If an entity repurchases a part of a financial liability, the entity shall allocate the previous carrying amount of the financial liability between the part that continues to be ~~recognised~~recognized and the part that is ~~derecognised~~derecognized based on the relative fair values of those parts on the date of the repurchase. The difference between (a) the carrying amount allocated to the part ~~derecognised~~derecognized and (b) the consideration paid, including any non-cash assets transferred or liabilities assumed, for the part ~~derecognised~~derecognized shall be ~~recognised~~recognized in ~~profit or loss~~surplus or deficit. [IFRS 9 Par. 3.3.4, IPSAS 29 Par. 44]

Classification

Classification of financial assets

38. Unless paragraph 434.1.5 applies, an entity shall classify financial assets as subsequently measured at ~~amortised~~amortized cost, fair value through ~~other comprehensive income~~net assets/equity or fair value through ~~profit or loss~~surplus or deficit on the basis of both:
 - (a) ~~The entity's business model~~management model for ~~managing the~~ financial assets; and
 - (b) ~~The~~ contractual cash flow characteristics of the financial asset. [IFRS 9 Par. 4.1.1]
39. A financial asset shall be measured at ~~amortised~~amortized cost if both of the following conditions are met:
 - (a) ~~The~~ financial asset is held within a ~~business model~~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.

Paragraphs AG39B4.1.1–AG79B4.1.26 provide guidance on how to apply these conditions. [IFRS 9 Par. 4.1.2]
40. A financial asset shall be measured at fair value through ~~other comprehensive income~~net assets/equity if both of the following conditions are met:

- (a) ~~The~~ financial asset is held within a ~~business model 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.

Paragraphs AG39~~B4.1.1~~–AG79~~B4.1.26~~ provide guidance on how to apply these conditions. [IFRS 9 Par. 4.1.2A]

41. For the purpose of applying paragraphs 39(b)~~4.1.2(b)~~ and 40(b)~~4.1.2A(b)~~:

- (a) ~~P~~principal is the fair value of the financial asset at initial recognition. Paragraph AG55~~B4.1.7B~~ provides additional guidance on the meaning of principal.
- (b) ~~I~~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. Paragraphs AG54~~B4.1.7A~~ and AG58~~B4.1.9A~~–AG62~~B4.1.9E~~ provide additional guidance on the meaning of interest, including the meaning of the time value of money. [IFRS 9 Par. 4.1.3]

42. A financial asset shall be measured at fair value through ~~profit or loss~~surplus or deficit unless it is measured at ~~amortised~~amortized cost in accordance with paragraph 39~~4.1.2~~ or at fair value through ~~other comprehensive income~~net assets/equity in accordance with paragraph 40~~4.2A~~. 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 ~~profit or loss~~surplus or deficit to present subsequent changes in fair value in ~~other comprehensive income~~net assets/equity (see paragraphs 102~~5.7.5~~–103~~5.7.6~~). [IFRS 9 Par. 4.1.4]

Option to designate a financial asset at fair value through ~~profit or loss~~surplus or deficit

43. Despite paragraphs 38~~4.1.1~~–42~~4.1.4~~, an entity may, at initial recognition, irrevocably designate a financial asset as measured at fair value through ~~profit or loss~~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~~recognizing the gains and losses on them on different bases (see paragraphs AG82~~B4.1.29~~–AG85~~B4.1.32~~). [IFRS 9 Par. 4.1.5]

Classification of financial liabilities

44. An entity shall classify all financial liabilities as subsequently measured at ~~amortised~~amortized cost, except for:

- (a) ~~F~~financial liabilities at fair value through ~~profit or loss~~surplus or deficit. Such liabilities, including derivatives that are liabilities, shall be subsequently measured at fair value. [IFRS 9 Par. 4.2.1 a), IPSAS 29 Par. 49 a)]
- (b) ~~F~~financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies. Paragraphs 25~~3.2.15~~ and 27~~3.2.17~~ apply to the measurement of such financial liabilities. [IFRS 9 Par. 4.2.1 b), IPSAS 29 Par. 49 b)]

- (c) **F**inancial guarantee contracts. After initial recognition, an issuer of such a contract shall (unless paragraph (a) ~~4.2.1(a)~~ or (b) ~~(b)~~ applies) subsequently measure it at the higher of:
 - (i) ~~T~~he amount of the loss allowance determined in accordance with paragraphs 70–89; Section 5.5 and [IFRS 9 Par. 4.2.1 c) i), IPSAS 29 Par. 49 c) i)]
 - (ii) ~~T~~he amount initially ~~recognised~~recognized (see paragraph ~~565.1.4~~) less, when appropriate, the cumulative amount of ~~income~~amortization ~~recognised~~recognized in accordance with the principles of ~~IFRS 15~~IPSAS 9. [IFRS 9 Par. 4.2.1 c) ii), IPSAS 29 Par. 49 c) ii)]
- (d) **C**ommitments to provide a loan at a below-market interest rate. An issuer of such a commitment shall (unless paragraph (a) ~~4.2.1(a)~~ applies) subsequently measure it at the higher of:
 - (i) ~~T~~he amount of the loss allowance determined in accordance with paragraphs 70–89; Section 5.5 and [IFRS 9 Par. 4.2.1 d) i), IPSAS 29 Par. 49 d) i)]
 - (ii) ~~(T~~he amount initially ~~recognised~~recognized (see paragraph ~~565.1.4~~) less, when appropriate, the cumulative amount of ~~income~~amortization ~~recognised~~recognized in accordance with the principles of ~~IFRS 15~~IPSAS 9. [IFRS 9 Par. 4.2.1 d) ii), IPSAS 29 Par. 49 d) ii)]
- (e) **C**ontingent consideration ~~recognised~~recognized by an acquirer in a ~~business entity~~ combination to which ~~IFRS 3~~IPSAS XX applies. Such contingent consideration shall subsequently be measured at fair value with changes ~~recognised~~recognized in ~~profit or loss~~surplus or deficit. [IFRS 9 Par. 4.2.1 e), no equivalent IPSAS 29 paragraph]

Option to designate a financial liability at fair value through ~~profit or loss~~surplus or deficit

45. An entity may, at initial recognition, irrevocably designate a financial liability as measured at fair value through ~~profit or loss~~surplus or deficit when permitted by paragraph ~~504.3.5~~, or when doing so results in more relevant information, because either:
- (a) ~~i~~t 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~~recognizing the gains and losses on them on different bases (see paragraphs ~~AG82B4.1.29–AG85B4.1.32~~); 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 ~~IAS 24~~IPSAS 20 Related Party Disclosures), for example, the entity’s ~~board of directors~~governing body and chief executive officer (see paragraphs ~~AG86B4.1.33–AG89B4.1.36~~). [IFRS 9 Par. 4.2.2, IPSAS 29 Par. 10]

Embedded derivatives

46. 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. [IFRS 9 Par. 4.3.1, IPSAS 29 Par. 11]

Hybrid contracts with financial asset hosts

47. If a hybrid contract contains a host that is an asset within the scope of this Standard, an entity shall apply the requirements in paragraphs 384.1.1–434.1.5 to the entire hybrid contract. [IFRS 9 Par. 4.3.2, no IPSAS 29 equivalent paragraph]

Other hybrid contracts

48. If a hybrid contract contains a host that is not an asset within the scope of this Standard, an embedded derivative shall be separated from the host and accounted for as a derivative under this Standard if, and only if:
- (a) ~~the~~ The economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host (see paragraphs 92B4.3.5 and 95B4.3.8);
 - (b) ~~A~~ a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
 - (c) ~~the~~ The hybrid contract is not measured at fair value with changes in fair value ~~recognised~~ recognized in ~~profit or loss~~ surplus or deficit (i.e., a derivative that is embedded in a financial liability at fair value through ~~profit or loss~~ surplus or deficit is not separated). [IFRS 9 Par. 4.3.3, IPSAS 29 Par. 12]
49. If an embedded derivative is separated, the host contract shall be accounted for in accordance with the appropriate Standards. This Standard does not address whether an embedded derivative shall be presented separately in the statement of financial position. [IFRS 9 Par. 4.3.4, IPSAS 29 Par 12]
50. Despite paragraphs 484.3.3 and 494.3.4, if a contract contains one or more embedded derivatives and the host is not an asset within the scope of this Standard, an entity may designate the entire hybrid contract as at fair value through ~~profit or loss~~ surplus or deficit unless:
- (a) ~~the~~ The embedded derivative(s) do(es) not significantly modify the cash flows that otherwise would be required by the contract; or
 - (b) ~~it~~ 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~~ amortized cost. [IFRS 9 Par. 4.3.5, IPSAS 29 Par. 13]
51. If an entity is required by this Standard 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 ~~profit or loss~~ surplus or deficit. [IFRS 9 Par. 4.3.6, IPSAS 29, Par. 14]
52. 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 514.3.6 applies and the hybrid contract is designated as at fair value through ~~profit or loss~~ surplus or deficit. [IFRS 9 Par. 4.3.7, IPSAS 29 Par. 15]

Reclassification

53. When, and only when, an entity changes its ~~business model~~ management model for ~~managing~~ financial assets it shall reclassify all affected financial assets in accordance with paragraphs 384.1.1–424.1.4. See paragraphs 905.6.1–965.6.7, AG102B4.4.1–AG104B4.4.3 and AG208B5.6.1–AG209B5.6.2 for additional guidance on reclassifying financial assets. [IFRS 9 Par. 4.4.1]
54. An entity shall not reclassify any financial liability. [IFRS 9 Par. 4.4.2]
55. The following changes in circumstances are not reclassifications for the purposes of paragraphs 534.4.1–544.4.2:
 - (a) ~~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) ~~A~~an item becomes a designated and effective hedging instrument in a cash flow hedge or net investment hedge; and
 - (c) ~~C~~changes in measurement in accordance with ~~Section 6.7~~ paragraphs XX–XX. [IFRS 9 Par. 4.4.3]

Measurement

Initial measurement

56. ~~Except for trade receivables within the scope of paragraph 5.1.3, a~~At initial recognition, an entity shall measure a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through ~~profit or loss~~ surplus or deficit, *transaction costs* that are directly attributable to the acquisition or issue of the financial asset or financial liability. [IFRS 9 Par. 5.1.1, IPSAS 29 Par. 45]

~~1. However, if the fair value of the financial asset or financial liability at initial recognition differs from the transaction price, an entity shall apply paragraph B5.1.2AAG106. [IFRS 9 Par. 5.1.1A, no IPSAS 29 equivalent]~~
57. When an entity uses settlement date accounting for an asset that is subsequently measured at ~~amortised~~ amortized cost, the asset is ~~recognised~~ recognized initially at its fair value on the trade date (see paragraphs AG9B3.1.3–AG12B3.1.6). [IFRS 9 Par. 5.1.2, IPSAS 29 Par. 46]

~~Despite the requirement in paragraph 5.1.1, at initial recognition, an entity shall measure trade receivables at their transaction price (as defined in IFRS 15) if the trade receivables do not contain a significant financing component in accordance with IFRS 15 (or when the entity applies the practical expedient in accordance with paragraph 63 of IFRS 15). [IFRS 9 Par. 5.1.3 no IPSAS 29 equivalent]~~

Subsequent measurement of financial assets

58. After initial recognition, an entity shall measure a financial asset in accordance with paragraphs 384.1.1–434.1.5 at:

- (a) Amortized cost;
 - (b) Fair value through ~~other comprehensive income~~ net assets/equity; or
 - (c) Fair value through ~~profit or loss~~ surplus or deficit. [IFRS 9 Par. 5.2.1]
59. An entity shall apply the impairment requirements in paragraphs 70–89 ~~Section 5.5~~ to financial assets that are measured at amortized ~~amortised~~ cost in accordance with paragraph 39 ~~4.1.2~~ and to financial assets that are measured at fair value through ~~other comprehensive income~~ net assets/equity in accordance with paragraph 40 ~~4.1.2A~~. [IFRS 9 Par. 5.2.2, IPSAS 29 Par. 67]
60. An entity shall apply the hedge accounting requirements in paragraphs XX6.5.8–XX6.5.14 (and, if applicable, paragraphs 8998–94–105 of IPSAS 29 ~~IAS 39~~ *Financial Instruments: Recognition and Measurement*) for the fair value hedge accounting for a portfolio hedge of interest rate risk) to a financial asset that is designated as a hedged item.⁸ [IFRS 9 Par. 5.2.3]

Subsequent measurement of financial liabilities

61. After initial recognition, an entity shall measure a financial liability in accordance with paragraphs 44 ~~4.2.1–45~~ 4.2.2. [IFRS 9 Par. 5.3.1]
62. An entity shall apply the hedge accounting requirements in paragraphs XX6.5.8–XX6.5.14 (and, if applicable, paragraphs 9889–10594 of IPSAS 29 ~~IAS 39~~ for the fair value hedge accounting for a portfolio hedge of interest rate risk) to a financial liability that is designated as a hedged item. [IFRS 9 Par. 5.3.2, no IPSAS 29 equivalent]

Fair value measurement considerations

63. In determining the fair value of a financial asset or a financial liability for the purpose of applying this Standard, IPSAS 28 or IPSAS 30, an entity shall apply paragraphs AG131–AG143 of Appendix A. [No IFRS 9 equivalent, IPSAS 29 Par. 50]
64. 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. The objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal operating considerations. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, if available, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the entity uses that technique. The chosen valuation technique makes maximum use of market inputs and relies as little as possible on entity-specific inputs. It incorporates all factors that market participants would consider in setting a price and is consistent with accepted economic methodologies for pricing financial instruments. Periodically,

⁸ In accordance with paragraph XX.7.2.24, an entity may choose as its accounting policy to continue to apply the hedge accounting requirements in IAS 39 ~~IPSAS 29~~ instead of the requirements in Chapter 6 ~~paragraphs XX–XX~~ of this Standard. If an entity has made this election, the references in this Standard to particular hedge accounting requirements in paragraphs XX–XX ~~Chapter 6xx~~ are not relevant. Instead the entity applies the relevant hedge accounting requirements in IAS 39 ~~IPSAS 29~~.

an entity calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on any available observable market data. [No IFRS 9 equivalent, IPSAS 29 Par. 51]

63:65. The fair value of a financial liability with a demand feature (e.g., a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid. [No IFRS 9 equivalent, IPSAS 29 Par. 52]

Amortized cost measurement

Financial assets

Effective interest method

64:66. Interest revenue shall be calculated by using the *effective interest method* (see Appendix A and paragraphs AG144B5.4.1–AG150B5.4.7). This shall be calculated by applying the *effective interest rate* to the *gross carrying amount of a financial asset* except for:

- (a) ~~p~~Purchased or originated credit-impaired financial assets. For those financial assets, the entity shall apply the *credit-adjusted effective interest rate* to the ~~amortised~~*amortized* cost of the financial asset from initial recognition.
- (b) ~~F~~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~~*amortized* cost of the financial asset in subsequent reporting periods. [IFRS 9 Par. 5.4.1]

65:67. An entity that, in a reporting period, calculates interest revenue by applying the effective interest method to the ~~amortised~~*amortized* cost of a financial asset in accordance with paragraph 66(b)~~5.4.1(b)~~, 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 66(b)~~5.4.1(b)~~ were applied (such as an improvement in the borrower's credit rating). [IFRS 9 Par. 5.4.2]

Modification of contractual cash flows

66:68. 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 Standard, an entity shall recalculate the gross carrying amount of the financial asset and shall ~~recognise~~*recognize* a *modification gain or loss* in ~~profit or loss~~*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 ~~XX~~*6.5.10*. Any costs or fees incurred adjust the carrying amount of the modified financial asset and are ~~amortised~~*amortized* over the remaining term of the modified financial asset. [IFRS 9 Par. 5.4.3]

Write-off

~~67-69.~~ 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 (see paragraph AG28(r)~~B3.2.16(+)~~). [IFRS 9 Par. 5.4.4 – no equivalent paragraph under IPSAS 29]

Impairment

Recognition of expected credit losses

General approach

~~68-70.~~ An entity shall ~~recognise~~**recognize** a loss allowance for *expected credit losses* on a financial asset that is measured in accordance with paragraphs 39~~4.1.2~~ or 40~~4.1.2A~~, a lease receivable, ~~a contract asset~~ or a loan commitment and a financial guarantee contract to which the impairment requirements apply in accordance with paragraphs 2(g)~~2.1(g)~~, 44(c)~~4.2.1(c)~~ or 44(d)~~4.2.1(d)~~. [IFRS 9 Par. 5.5.1]

~~69-71.~~ 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 ~~other comprehensive income~~**net assets/equity** in accordance with paragraph 40~~4.1.2A~~. However, the loss allowance shall be ~~recognised~~**recognized** in ~~other comprehensive income~~**net assets/equity** and shall not reduce the carrying amount of the financial asset in the statement of financial position. [IFRS 9 Par. 5.5.2]

~~70-72.~~ Subject to paragraphs 82~~5.5.13~~–85~~5.5.16~~, 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. [IFRS 9 Par. 5.5.3]

~~71-73.~~ The objective of the impairment requirements is to ~~recognise~~**recognize** 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. [IFRS 9 Par. 5.5.4]

~~72-74.~~ Subject to paragraphs 82~~5.5.13~~–85~~5.5.16~~, 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*. [IFRS 9 Par. 5.5.5]

~~73-75.~~ 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. [IFRS 9 Par. 5.5.6]

~~74-76.~~ 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 72~~5.5.3~~ 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. [IFRS 9 Par. 5.5.7]

~~75-77.~~ An entity shall ~~recognise~~**recognize** in ~~profit or loss~~**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~~recognized in accordance with this Standard. [IFRS 9 Par. 5.5.8]

Determining significant increases in credit risk

~~76-78.~~ 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. [IFRS 9 Par. 5.5.9]

~~77-79.~~ 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 (see paragraphs AG174~~B5.5.22~~–AG176~~B5.5.24~~). [IFRS 9 Par. 5.5.10]

~~78-80.~~ 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. [IFRS 9 Par. 5.5.11]

Modified financial assets

~~79-81.~~ If the contractual cash flows on a financial asset have been renegotiated or modified and the financial asset was not ~~derecognised~~derecognized, an entity shall assess whether there has been a significant increase in the credit risk of the financial instrument in accordance with paragraph 725-5-3 by comparing:

- (a) ~~T~~he risk of a default occurring at the reporting date (based on the modified contractual terms); and
- (b) ~~T~~he risk of a default occurring at initial recognition (based on the original, unmodified contractual terms). [IFRS 9 Par. 5.5.12]

Purchased or originated credit-impaired financial assets

~~80-82.~~ Despite paragraphs 725-5-3 and 745-5-5, at the reporting date, an entity shall only ~~recognise~~recognize the cumulative changes in lifetime expected credit losses since initial

recognition as a loss allowance for purchased or originated credit-impaired financial assets. [IFRS 9 Par. 5.5.13]

~~81-83.~~ At each reporting date, an entity shall ~~recognise~~recognize in ~~profit or loss~~surplus or deficit the amount of the change in lifetime expected credit losses as an impairment gain or loss. An entity shall ~~recognise~~recognize 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. [IFRS 9 Par. 5.5.14]

Simplified approach for ~~trade receivables, contract assets and lease receivables~~

~~82-84.~~ Despite paragraphs ~~725.5.3~~ and ~~745.5.5~~, an entity shall always measure the loss allowance at an amount equal to lifetime expected credit losses for:

- (a) ~~trade receivables~~ Receivables or ~~contract assets~~ that result from exchange transactions that are within the scope of IPSAS 9 and non-exchange transactions within the scope of IPSAS 23. ~~IFRS 15, and that:~~
 - ~~i. do not contain a significant financing component in accordance with IFRS 15 (or when the entity applies the practical expedient in accordance with paragraph 63 of IFRS 15); or~~
 - (i) ~~contain a significant financing component in accordance with IFRS 15, 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 such trade receivables or contract assets but may be applied separately to trade receivables and contract assets.~~
- (b) Lease receivables that result from transactions that are within the scope of ~~IFRS 16~~IPSAS 13, 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. [IFRS 9 Par. 5.5.15]

~~83-85.~~ An entity may select its accounting policy for trade receivables and, lease receivables and ~~contract assets~~ independently of each other. [IFRS 9 Par. 5.5.16]

Measurement of expected credit losses

~~84-86.~~ 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. [IFRS 9 Par. 5.5.17]

~~85-87.~~ 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. [IFRS 9 Par. 5.5.18]

~~86-88.~~ 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. [IFRS 9 Par. 5.5.19]

~~87-89.~~ 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. [IFRS 9 Par. 5.5.20]

Reclassification of financial assets

~~88-90.~~ If an entity reclassifies financial assets in accordance with paragraph 534.4.1, it shall apply the reclassification prospectively from the *reclassification date*. The entity shall not restate any previously ~~recognised~~recognized gains, losses (including impairment gains or losses) or interest. Paragraphs 915.6.2–965.6.7 set out the requirements for reclassifications. [IFRS 9 Par. 5.6.1]

~~89-91.~~ If an entity reclassifies a financial asset out of the ~~amortised~~amortized cost measurement category and into the fair value through ~~profit or loss~~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~~amortized cost of the financial asset and fair value is ~~recognised~~recognized in ~~profit or loss~~surplus or deficit. [IFRS 9 Par. 5.6.2]

~~90-92.~~ If an entity reclassifies a financial asset out of the fair value through ~~profit or loss~~surplus or deficit measurement category and into the ~~amortised~~amortized cost measurement category, its fair value at the reclassification date becomes its new gross carrying amount. (See paragraph AG209B5.6.2 for guidance on determining an effective interest rate and a loss allowance at the reclassification date.) [IFRS 9 Par. 5.6.3]

~~91-93.~~ If an entity reclassifies a financial asset out of the ~~amortised~~amortized cost measurement category and into the fair value through ~~other comprehensive income~~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~~amortized cost of the financial asset and fair value is ~~recognised~~recognized in ~~other comprehensive income~~net assets/equity. The effective interest rate and the measurement of expected credit losses are not adjusted as a result of the reclassification. (See paragraph AG208B5.6.4.) [IFRS 9 Par. 5.6.4]

~~92-94.~~ If an entity reclassifies a financial asset out of the fair value through ~~other comprehensive income~~net assets/equity measurement category and into the ~~amortised~~amortized cost measurement category, the financial asset is reclassified at its fair value at the reclassification date. However, the cumulative gain or loss previously ~~recognised~~recognized in ~~other comprehensive income~~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~~amortized cost. This adjustment affects ~~other comprehensive income~~net assets/equity but does not affect ~~profit or~~

~~loss~~surplus or deficit and therefore is not a reclassification adjustment (see ~~IAS 4~~IPSAS 1 *Presentation of Financial Statements*). The effective interest rate and the measurement of expected credit losses are not adjusted as a result of the reclassification. (See paragraph AG208~~B5.6.1~~.) [IFRS 9 Par. 5.6.5]

~~93-95.~~ If an entity reclassifies a financial asset out of the fair value through ~~profit or loss~~surplus or deficit measurement category and into the fair value through ~~other comprehensive income~~net assets/equity measurement category, the financial asset continues to be measured at fair value. (See paragraph AG209~~B5.6.2~~ for guidance on determining an effective interest rate and a loss allowance at the reclassification date.) [IFRS 9 Par. 5.6.6]

~~94-96.~~ If an entity reclassifies a financial asset out of the fair value through ~~other comprehensive income~~net assets/equity measurement category and into the fair value through ~~profit or loss~~surplus or deficit measurement category, the financial asset continues to be measured at fair value. The cumulative gain or loss previously ~~recognised~~recognized in ~~other comprehensive income~~net assets/equity is reclassified from ~~net assets/equity~~ to ~~profit or loss~~surplus or deficit as a reclassification adjustment (see ~~IAS-IPSAS~~ 1) at the reclassification date. [IFRS 9 Par. 5.6.7]

Gains and losses

~~95-97.~~ A gain or loss on a financial asset or financial liability that is measured at fair value shall be ~~recognised~~recognized in ~~profit or loss~~surplus or deficit unless:

- (a) ~~it~~ is part of a hedging relationship (see paragraphs ~~XX6.5.8-XX6.5.14~~ and, if applicable, paragraphs ~~89-94~~98-105 of ~~IAS 39~~IPSAS 29 for the fair value hedge accounting for a portfolio hedge of interest rate risk);
- (b) ~~it~~ is an investment in an equity instrument and the entity has elected to present gains and losses on that investment in ~~other comprehensive income~~net assets/equity in accordance with paragraph 102~~5.7.5~~;
- (c) ~~it~~ is a financial liability designated as at fair value through ~~profit or loss~~surplus or deficit and the entity is required to present the effects of changes in the liability's *credit risk* in ~~other comprehensive income~~net assets/equity in accordance with paragraph 104~~5.7.7~~; or
- (d) ~~it~~ is a financial asset measured at fair value through ~~other comprehensive income~~net assets/equity in accordance with paragraph 404.1.2A and the entity is required to ~~recognise~~recognize some changes in fair value in ~~other comprehensive income~~net assets/equity in accordance with paragraph 107~~5.7.10~~. [IFRS 9 Par. 5.7.1]

~~96-98.~~ *Dividends or similar distributions* are ~~recognised~~recognized in ~~profit or loss~~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. [IFRS 9 Par. 5.7.1A]

~~97-99.~~ A gain or loss on a financial asset that is measured at ~~amortised~~amortized cost and is not part of a hedging relationship (see paragraphs ~~XX6.5.8-XX6.5.14~~ and, if applicable, paragraphs ~~89-94~~98-105 of ~~IAS 39~~IPSAS 29 for the fair value hedge accounting for a

portfolio hedge of interest rate risk) shall be ~~recognised~~recognized in ~~profit or loss~~surplus or deficit when the financial asset is ~~derecognised~~derecognized, reclassified in accordance with paragraph 915.6.2, through the ~~amortisation~~ amortization process or in order to ~~recognise~~recognize impairment gains or losses. An entity shall apply paragraphs 915.6.2 and 935.6.4 if it reclassifies financial assets out of the ~~amortised~~amortized cost measurement category. A gain or loss on a financial liability that is measured at ~~amortised~~amortized cost and is not part of a hedging relationship (see paragraphs XX6.5.8–XX6.5.14 and, if applicable, paragraphs 98-10589–94 of IPSAS 29 IAS 39 for the fair value hedge accounting for a portfolio hedge of interest rate risk) shall be ~~recognised~~recognized in ~~profit or loss~~surplus or deficit when the financial liability is ~~derecognised~~derecognized and through the ~~amortisation~~ amortization process. (See paragraph AG212B5.7.2 for guidance on foreign exchange gains or losses.) [IFRS 9 Par. 5.7.2]

98-100. A gain or loss on financial assets or financial liabilities that are hedged items in a hedging relationship shall be ~~recognised~~recognized in accordance with paragraphs XX6.5.8–XX6.5.14 and, if applicable, paragraphs 98-10589–94 of IPSAS 29 IAS 39 for the fair value hedge accounting for a portfolio hedge of interest rate risk. [IFRS 9 Par. 5.7.3]

99-101. If an entity ~~recognise~~recognizes financial assets using settlement date accounting (see paragraphs 103.1.2, AG9B3.1.3 and AG12B3.1.6), any change in the fair value of the asset to be received during the period between the trade date and the settlement date is not ~~recognised~~recognized for assets measured at ~~amortised~~amortized cost. For assets measured at fair value, however, the change in fair value shall be ~~recognised~~recognized in ~~profit or loss~~surplus or deficit or in ~~other comprehensive income~~net assets/equity, as appropriate in accordance with paragraph 975.7.1. The trade date shall be considered the date of initial recognition for the purposes of applying the impairment requirements. [IFRS 9 Par. 5.7.4, IPSAS 29 Par. 66]

Investments in equity instruments

100-102. At initial recognition, an entity may make an irrevocable election to present in ~~other comprehensive income~~net assets/equity subsequent changes in the fair value of an investment in an equity instrument within the scope of this Standard that is neither *held for trading* nor contingent consideration ~~recognised~~recognized by an acquirer in an ~~business entity~~ combination to which IFRS 3 applies. (See paragraph AG214B5.7.3 for guidance on foreign exchange gains or losses.) [IFRS 9 Par. 5.7.5]

101-103. If an entity makes the election in paragraph 1025.7.5, it shall ~~recognise~~recognize in ~~profit or loss~~surplus or deficit dividends or similar distributions from that investment in accordance with paragraph 985.7.1A. [IFRS 9 Par. 5.7.6]

Liabilities designated as at fair value through ~~profit or loss~~surplus or deficit

102-104. An entity shall present a gain or loss on a financial liability that is designated as at fair value through ~~profit or loss~~surplus or deficit in accordance with paragraph 454.2.2 or paragraph 504.3.5 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 ~~other comprehensive income~~ net assets/equity (see paragraphs AG224B5.7.13–AG231B5.7.20), and
- (b) ~~The~~ remaining amount of change in the fair value of the liability shall be presented in ~~profit or loss~~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 ~~profit or loss~~surplus or deficit (in which case paragraph 105~~5.7.8~~ applies). Paragraphs AG216~~B5.7.5~~–AG218~~B5.7.7~~ and AG221~~B5.7.10~~–AG223~~B5.7.12~~ provide guidance on determining whether an accounting mismatch would be created or enlarged. [IFRS 9 Par. 5.7.7]

~~403.105.~~ If the requirements in paragraph 104~~5.7.7~~ would create or enlarge an accounting mismatch in ~~profit or loss~~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 ~~profit or loss~~surplus or deficit. [IFRS 9 Par. 5.7.8]

~~404.106.~~ Despite the requirements in paragraphs 104~~5.7.7~~ and 105~~5.7.8~~, an entity shall present in ~~profit or loss~~surplus or deficit all gains and losses on loan commitments and financial guarantee contracts that are designated as at fair value through ~~profit or loss~~surplus or deficit. [IFRS 9 Par. 5.7.9]

Assets measured at fair value through ~~other comprehensive income~~net assets/equity

~~405.107.~~ A gain or loss on a financial asset measured at fair value through ~~other comprehensive income~~net assets/equity in accordance with paragraph 404.1.2A shall be ~~recognised~~recognized in ~~other comprehensive income~~net assets/equity, except for impairment gains or losses (see ~~paragraphs 70–89~~Section 5.5) and foreign exchange gains and losses (see paragraphs AG212~~B5.7.2~~–AG213~~B5.7.2A~~), until the financial asset is ~~derecognised~~derecognized or reclassified. When the financial asset is ~~derecognised~~derecognized the cumulative gain or loss previously ~~recognised~~recognized in ~~other comprehensive income~~net assets/equity is reclassified from net assets/ equity to ~~profit or loss~~surplus or deficit as a reclassification adjustment (see ~~IAS 41~~IPSAS 1). If the financial asset is reclassified out of the fair value through ~~other comprehensive income~~net assets/equity measurement category, the entity shall account for the cumulative gain or loss that was previously ~~recognised~~recognized in ~~other comprehensive income~~net assets/equity in accordance with paragraphs 94~~5.6.5~~ and 96~~5.6.7~~. Interest calculated using the effective interest method is ~~recognised~~recognized in ~~profit or loss~~surplus or deficit. [IFRS 9 Par. 5.7.10]

~~406.108.~~ As described in paragraph 107~~5.7.10~~, if a financial asset is measured at fair value through ~~other comprehensive income~~net assets/equity in accordance with paragraph 404.1.2A, the amounts that are ~~recognised~~recognized in ~~profit or loss~~surplus or deficit are the same as the amounts that would have been ~~recognised~~recognized in ~~profit or loss~~surplus or deficit if the financial asset had been measured at ~~amortised~~amortized cost. [IFRS 9 Par. 5.7.11]

Defined Terms

This appendix is an integral part of [draft] IPSAS [X] (ED XX).

12-month expected credit losses

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.

~~amortised~~amortized cost of a financial asset or financial liability

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~~ amortization 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.

~~contract assets~~

~~Those rights that IFRS 15 Revenue from Contracts with Customers specifies are accounted for in accordance with this Standard for the purposes of recognising and measuring impairment gains or losses.~~

credit-impaired financial asset

A financial asset 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 reorganization;
- (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

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-adjusted effective interest rate

The rate that exactly discounts the estimated future cash payments or receipts through the expected life of the financial asset to the ~~amortised~~**amortized cost of a financial asset** that is a **purchased or originated credit-impaired financial asset**. When calculating the credit-adjusted effective interest rate, an entity shall estimate the expected cash flows by considering all contractual terms of the financial asset (for example, prepayment, extension, call and similar options) and **expected credit losses**. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate (see paragraphs AG144~~B5.4.1~~–AG146~~B5.4.3~~), **transaction costs**, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the cash flows or the remaining life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments).

derecognition

The removal of a previously ~~recognised~~**recognized** financial asset or financial liability from an entity's statement of financial position.

derivative

A financial instrument or other contract within the scope of this Standard 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.

<u>dividends or similar distributions</u>	Distributions of profits to holders of equity instruments in proportion to their holdings of a particular class of capital.
effective interest method	The method that is used in the calculation of the amortised amortized cost of a financial asset or a financial liability and in the allocation and recognition of the interest revenue or interest expense in profit or loss surplus or deficit over the relevant period.
effective interest rate	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 amortized cost of a financial liability . When calculating the effective interest rate, an entity shall estimate the expected cash flows by considering all the contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) but shall not consider the expected credit losses . The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate (see paragraphs AG144 B5.4.1–AG146B5.4.3), transaction costs , and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the cash flows or the expected life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments).
expected credit losses	The weighted average of credit losses with the respective risks of a default occurring as the weights.
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.
financial liability at fair value through profit or losssurplus or deficit	A financial liability that meets one of the following conditions: <ul style="list-style-type: none"> (a) it meets the definition of held for trading. (b) upon initial recognition it is designated by the entity as at fair value through profit or losssurplus or deficit in accordance with paragraph 454.2.2 or 504.3.5. (c) it is designated either upon initial recognition or subsequently as at fair value through profit or losssurplus or deficit in accordance with paragraph XX6.7.1.
firm commitment	A binding agreement for the exchange of a specified quantity of resources at a specified price on a specified future date or dates.
forecast transaction	An uncommitted but anticipated future transaction.
gross carrying amount of a financial asset	The amortised amortized cost of a financial asset , before adjusting for any loss allowance .

hedge ratio	The relationship between the quantity of the hedging instrument and the quantity of the hedged item in terms of their relative weighting.
held for trading	<p>A financial asset or financial liability that:</p> <ul style="list-style-type: none"> • (a) is acquired or incurred principally for the purpose of selling or repurchasing it in the near term; • (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).
impairment gain or loss	Gains or losses that are recognised recognized in profit or loss surplus or deficit in accordance with paragraph 775.5.8 and that arise from applying the impairment requirements in paragraphs 70–89 Section 5.5.
lifetime expected credit losses	The expected credit losses that result from all possible default events over the expected life of a financial instrument.
loss allowance	The allowance for expected credit losses on financial assets measured in accordance with paragraph 394.1.2, lease receivables and contract assets , the accumulated impairment amount for financial assets measured in accordance with paragraph 404.1.2A and the provision for expected credit losses on loan commitments and financial guarantee contracts .
modification gain or loss	<p>The amount arising from adjusting the gross carrying amount of a financial asset to reflect the renegotiated or modified contractual cash flows. The entity recalculates the gross carrying amount of a financial asset as the present value of the estimated future cash payments or receipts through the expected life of the renegotiated or modified financial asset that are discounted at the financial asset's original effective interest rate (or the original 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 XX 6.5.10. When estimating the expected cash flows of a financial asset, an entity shall consider all contractual terms of the financial asset (for example, prepayment, call and similar options) but shall not consider the expected credit losses, unless the financial asset is a purchased or originated credit-impaired financial asset, in which case an entity shall also consider the initial expected credit losses that were considered when calculating the original credit-adjusted effective interest rate.</p>
past due	A financial asset is past due when a counterparty has failed to make a payment when that payment was contractually due.
purchased or originated credit-impaired financial asset	Purchased or originated financial asset(s) that are credit-impaired on initial recognition.

reclassification date	The first day of the first reporting period following the change in business model <u>management model</u> that results in an entity reclassifying financial assets.
regular way purchase or sale	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	Incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability (see paragraph B5.4.8). 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 following terms are defined in paragraph ~~11-9~~ of ~~IAS 32~~ IPSAS 28, ~~Appendix A and paragraph 8 of IFRS 7~~ IPSAS 30, ~~Appendix A of IFRS 13 or Appendix A of IFRS 15~~ and are used in this Standard with the meanings specified in ~~IPSAS 28~~IAS 32, ~~and IFRS 7~~IPSAS 30, ~~IFRS 13 or IFRS 15~~:

- (a) credit risk;⁹
- (b) equity instrument;
- ~~(c) fair value;~~
- ~~(c)~~ financial asset;
- ~~(d)~~ financial instrument;
- ~~(e)~~ financial liability;
- ~~(g) transaction price.~~

⁹ This term (as defined in ~~IFRS 7~~IPSAS 30) is used in the requirements for presenting the effects of changes in credit risk on liabilities designated as at fair value through ~~profit or loss~~surplus or deficit (see paragraph 1045-7-7).

Application Guidance

This Appendix is an integral part of [draft] IPSAS [X] (ED XX)

Scope

AG1. Some contracts require a payment based on climatic, geological or other physical variables. (Those based on climatic variables are sometimes referred to as 'weather derivatives'.) If those contracts are not ~~within the scope of IFRS 4 Insurance Contracts~~, they are within the scope of this Standard. [IFRS 9 Par. B2.1, IPSAS 29 AG5]

AG2. This Standard does not change the requirements relating to employee benefit plans that comply with ~~IAS 26 Accounting and Reporting by Retirement Benefit Plans~~ the relevant international or national accounting standard on accounting and reporting by retirement benefit plans and royalty agreements based on the volume of sales or service revenues that are accounted for under ~~IFRS 15 Revenue from Contracts with Customers~~ IPSAS 9. [IFRS 9 Par. B2.2, IPSAS 29 AG1]

AG3. Sometimes, an entity makes what it views as a 'strategic investment' in equity instruments issued by another entity, with the ~~intention~~ management model of establishing or maintaining a long-term operating relationship with the entity in which the investment is made. The investor or joint venturer entity uses ~~IAS 28~~ IPSAS 36 Investments in Associates and Joint Ventures to determine whether the equity method of accounting shall be applied to such an investment. [IFRS 9 Par. B2.3, IPSAS 29 AG2]

AG4. This Standard applies to the financial assets and financial liabilities of insurers, other than rights and obligations that paragraph 2(e) ~~2.1(e)~~ excludes because they arise ~~under contracts within the scope of IFRS 4~~ from insurance contracts.

An entity does however apply this Standard to:

- Financial guarantee contracts, except those where the issuer elects to treat such contracts as insurance contracts in accordance with IPSAS 28; and
- Embedded derivatives included in insurance contracts.

An entity may, but is not required to, apply this Standard to other insurance contracts that involve the transfer of financial risk. [IFRS 9 Par. B2.4, IPSAS 29 AG3]

AG5. Financial guarantee contracts may have various legal forms, such as a guarantee, some types of letter of credit, a credit default contract or an insurance contract. Their accounting treatment does not depend on their legal form. The following are examples of the appropriate treatment (see paragraph 2(e) ~~2.1(e)~~):

- (a) Although a financial guarantee contract meets the definition of an insurance contract in IFRS 4 if the risk transferred is significant, the issuer applies this Standard. Nevertheless, an entity may elect, under certain circumstances, to treat financial guarantee contracts as insurance contracts of financial instruments using IPSAS 28 if the issuer has previously adopted an accounting policy that treated financial guarantee contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either this Standard or the relevant international or national accounting standard on insurance contracts to such financial guarantee contracts. If this Standard applies, paragraph 56 requires the issuer to recognize a financial guarantee

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~~contract initially at fair value if the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting that is applicable to insurance contracts, the issuer may elect to apply either this Standard or IFRS 4 to such financial guarantee contracts. If this Standard applies, paragraph 5.1.1 requires the issuer to recognise a financial guarantee contract initially at fair value.~~ If the financial guarantee contract was issued to an unrelated party in a stand-alone arm's length transaction, its fair value at inception is likely to equal the premium received, unless there is evidence to the contrary. Subsequently, unless the financial guarantee contract was designated at inception as at fair value through ~~profit or loss~~ surplus or deficit or unless paragraphs ~~253.2.15–333.2.23~~ and ~~AG24B3.2.12–AG29B3.2.17~~ apply (when a transfer of a financial asset does not qualify for derecognition or the continuing involvement approach applies), the issuer measures it at the higher of:

- (i) ~~The~~ the amount determined in accordance with ~~paragraphs 70–89~~ Section 5.5; and
 - (ii) ~~The~~ the amount initially ~~recognised~~ recognized less, when appropriate, the cumulative ~~amount of income amortization~~ recognised recognized in accordance with the principles of ~~IFRS 15~~ IPSAS 9 (see paragraph 44(c) ~~4.2.1(e)~~). [IFRS 9 Par. B2.5a, IPSAS 29 AG4 a]
- (b) Some credit-related guarantees do not, as a precondition for payment, require that the holder is exposed to, and has incurred a loss on, the failure of the debtor to make payments on the guaranteed asset when due. An example of such a guarantee is one that requires payments in response to changes in a specified credit rating or credit index. Such guarantees are not financial guarantee contracts as defined in this Standard, and are not insurance contracts ~~as defined in IFRS 4~~. Such guarantees are derivatives and the issuer applies this Standard to them. [IFRS 9 Par. B2.5b, IPSAS 29 AG4 b]
- (c) If a financial guarantee contract was issued in connection with the sale of goods, the issuer applies ~~IFRS 15~~ IPSAS 9 in determining when it ~~recognise~~ recognizes the revenue from the guarantee and from the sale of goods. [IFRS 9 Par. B2.5c, IPSAS 29 AG4 c]

~~Assertions that an issuer regards contracts as insurance contracts are typically found throughout the issuer's communications with customers and regulators, contracts, business documentation and financial statements. Furthermore, insurance contracts are often subject to accounting requirements that are distinct from the requirements for other types of transaction, such as contracts issued by banks or commercial companies. In such cases, an issuer's financial statements typically include a statement that the issuer has used those accounting requirements.~~ [IFRS 9 Par. B2.6]

- AG6. Rights and obligations (assets and liabilities) may arise from non-exchange revenue transactions, for example, an entity may receive cash from a multi-lateral agency to perform certain activities. Where the performance of those activities is subject to conditions, an asset and a liability is recognized simultaneously. Where the asset is a financial asset, it is recognized in accordance with IPSAS 23, and initially measured in accordance with IPSAS 23 and this Standard. A liability that is initially recognized as a result of conditions imposed on the use of an asset is outside the scope of this Standard and is dealt with in IPSAS 23. After initial recognition, if circumstances indicate that recognition of a liability in accordance with IPSAS 23 is no longer appropriate, an entity considers whether a financial liability should be recognized in accordance with this Standard. Other liabilities that may arise from non-exchange revenue transactions are recognized and measured in accordance with this Standard if they meet the definition of a financial liability in IPSAS 28. [No IFRS 9 equivalent paragraph, IPSAS 29 AG6]

Recognition and derecognition

Initial recognition

- AG7. As a consequence of the principle in paragraph 93.1.4, an entity ~~recognises~~recognizes all of its contractual rights and obligations under derivatives in its statement of financial position as assets and liabilities, respectively, except for derivatives that prevent a transfer of financial assets from being accounted for as a sale (see paragraph AG26~~B3.2.14~~). If a transfer of a financial asset does not qualify for derecognition, the transferee does not ~~recognise~~recognize the transferred asset as its asset (see paragraph AG27~~B3.2.15~~). [IFRS 9 Par. B3.1.1, IPSAS 29 AG49]
- AG8. The following are examples of applying the principle in paragraph 93.1.4:
- (a) Unconditional receivables and payables are ~~recognised~~recognized as assets or liabilities when the entity becomes a party to the contract and, as a consequence, has a legal right to receive or a legal obligation to pay cash.
 - (b) Assets to be acquired and liabilities to be incurred as a result of a firm commitment to purchase or sell goods or services are generally not ~~recognised~~recognized until at least one of the parties has performed under the agreement. For example, an entity that receives a firm order does not generally ~~recognise~~recognize an asset (and the entity that places the order does not ~~recognise~~recognize a liability) at the time of the commitment but, instead, delays recognition until the ordered goods or services have been shipped, delivered or rendered. If a firm commitment to buy or sell non-financial items is within the scope of this Standard in accordance with paragraphs 52.4–82.7, its net fair value is ~~recognised~~recognized as an asset or a liability on the commitment date (see paragraph AG83(c)~~B4.1.30(c)~~). In addition, if a previously un~~recognised~~recognized firm commitment is designated as a hedged item in a fair value hedge, any change in the net fair value attributable to the hedged risk is ~~recognised~~recognized as an asset or a liability after the inception of the hedge (see paragraphs ~~XX6.5.8(b)~~ and ~~XX6.5.9~~).
 - (c) A forward contract that is within the scope of this Standard (see paragraph 22.4) is ~~recognised~~recognized as an asset or a liability on the commitment date, instead of on the date on which settlement takes place. When an entity becomes a party to a forward contract, the fair values of the right and obligation are often equal, so that the net fair value of the forward is zero. If the net fair value of the right and obligation is not zero, the contract is ~~recognised~~recognized as an asset or liability.
 - (d) Option contracts that are within the scope of this Standard (see paragraph 22.4) are ~~recognised~~recognized as assets or liabilities when the holder or writer becomes a party to the contract.
 - (e) Planned future transactions, no matter how likely, are not assets and liabilities because the entity has not become a party to a contract. [IFRS 9 Par. B3.1.2, IPSAS 29 AG50]

Regular way purchase or sale of financial assets

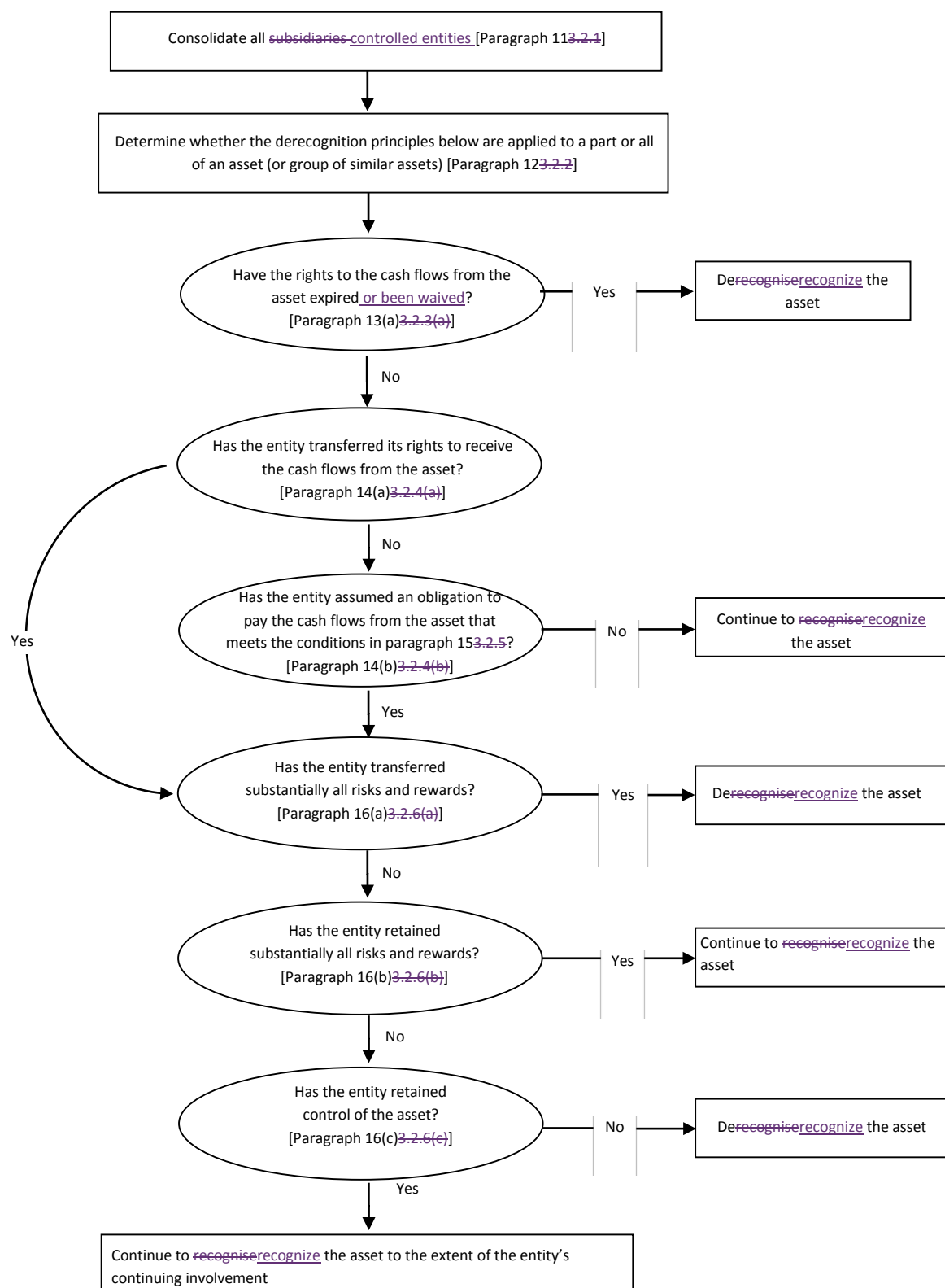
- AG9. A regular way purchase or sale of financial assets is ~~recognised~~recognized using either trade date accounting or settlement date accounting as described in paragraphs AG11~~B3.1.5~~ and AG12~~B3.1.6~~. An entity shall apply the same method consistently for all purchases and sales of financial assets that are classified in the same way in accordance with this Standard. For this purpose assets that are mandatorily measured at fair value through ~~profit or loss~~surplus or deficit form a separate classification from assets designated as measured at fair value through

~~profit or loss~~ surplus or deficit. In addition, investments in equity instruments accounted for using the option provided in paragraph 1025.7.5 form a separate classification. [IFRS 9 Par. B3.1.3, IPSAS 29 AG68]

- AG10. A contract that requires or permits net settlement of the change in the value of the contract is not a regular way contract. Instead, such a contract is accounted for as a derivative in the period between the trade date and the settlement date. [IFRS 9 Par. B3.1.4, IPSAS 29 AG 69]
- AG11. The trade date is the date that an entity commits itself to purchase or sell an asset. Trade date accounting refers to (a) the recognition of an asset to be received and the liability to pay for it on the trade date, and (b) derecognition of an asset that is sold, recognition of any gain or loss on disposal and the recognition of a receivable from the buyer for payment on the trade date. Generally, interest does not start to accrue on the asset and corresponding liability until the settlement date when title passes. [IFRS 9 Par. B3.1.5, IPSAS 29 AG 70]
- AG12. The settlement date is the date that an asset is delivered to or by an entity. Settlement date accounting refers to (a) the recognition of an asset on the day it is received by the entity, and (b) the derecognition of an asset and recognition of any gain or loss on disposal on the day that it is delivered by the entity. When settlement date accounting is applied an entity accounts for any change in the fair value of the asset to be received during the period between the trade date and the settlement date in the same way as it accounts for the acquired asset. In other words, the change in value is not ~~recognised~~ recognized for assets measured at ~~amortised~~ amortized cost; it is ~~recognised~~ recognized in ~~profit or loss~~ surplus or deficit for assets classified as financial assets measured at fair value through ~~profit or loss~~ surplus or deficit; and it is ~~recognised~~ recognized in ~~other comprehensive income~~ net assets/equity for financial assets measured at fair value through ~~other comprehensive income~~ net assets/equity in accordance with paragraph 404.1.2A and for investments in equity instruments accounted for in accordance with paragraph 1025.7.5. [IFRS 9 Par. B3.1.6, IPSAS 29 AG 71]

Derecognition of financial assets

AG13. The following flow chart illustrates the evaluation of whether and to what extent a financial asset is derecognized. [IFRS 9 Par. B3.2.1, IPSAS 29 AG 51]



Arrangements under which 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 recipients (paragraph 14(b)~~3.2.4(b)~~)

AG14. The situation described in paragraph 14(b)~~3.2.4(b)~~ (when an entity 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) occurs, for example, if the entity is a trust, and issues to investors beneficial interests in the underlying financial assets that it owns and provides servicing of those financial assets. In that case, the financial assets qualify for derecognition if the conditions in paragraphs 15~~3.2.5~~ and 16~~3.2.6~~ are met. [IFRS 9 Par. B3.2.2, IPSAS 29 AG52]

AG15. In applying paragraph 15~~3.2.5~~, the entity could be, for example, the originator of the financial asset, or it could be an group-economic entity that includes a subsidiary-controlled entity that has acquired the financial asset and passes on cash flows to unrelated third party investors. [IFRS 9 Par. B3.2.3, IPSAS 29 AG53]

Evaluation of the transfer of risks and rewards of ownership (paragraph 16~~3.2.6~~)

AG16. Examples of when an entity has transferred substantially all the risks and rewards of ownership are:

- (a) ~~Aa~~ an unconditional sale of a financial asset;
- (b) ~~Aa~~ a sale of a financial asset together with an option to repurchase the financial asset at its fair value at the time of repurchase; and
- (c) ~~Aa~~ a sale of a financial asset together with a put or call option that is deeply out of the money (i.e., an option that is so far out of the money it is highly unlikely to go into the money before expiry). [IFRS B3.2.4, IPSAS 29 AG54]

AG17. Examples of when an entity has retained substantially all the risks and rewards of ownership are:

- (a) ~~Aa~~ a sale and repurchase transaction where the repurchase price is a fixed price or the sale price plus a lender's return;
- (b) ~~Aa~~ a securities lending agreement;
- (c) ~~Aa~~ a sale of a financial asset together with a total return swap that transfers the market risk exposure back to the entity;
- (d) ~~Aa~~ a sale of a financial asset together with a deep in-the-money put or call option (i.e., an option that is so far in the money that it is highly unlikely to go out of the money before expiry); and
- (e) ~~Aa~~ a sale of short-term receivables in which the entity guarantees to compensate the transferee for credit losses that are likely to occur. [IFRS 9 Par. B3.2.5, IPSAS 29 AG55]

AG18. If an entity determines that as a result of the transfer, it has transferred substantially all the risks and rewards of ownership of the transferred asset, it does not ~~recognise~~recognize the transferred asset again in a future period, unless it reacquires the transferred asset in a new transaction. [IFRS 9 Par. B3.2.6, IPSAS 29 AG56]

Evaluation of the transfer of control

AG19. An entity has not retained control of a transferred asset if the transferee has the practical ability to sell the transferred asset. An entity has retained control of a transferred asset if the transferee does not have the practical ability to sell the transferred asset. A transferee has the practical ability to sell the transferred asset if it is traded in an active market because the transferee could repurchase the transferred asset in the market if it needs to return the asset to the entity. For example, a transferee may have the practical ability to sell a transferred asset if the transferred asset is subject to an option that allows the entity to repurchase it, but the transferee can readily obtain the transferred asset in the market if the option is exercised. A transferee does not have the practical ability to sell the transferred asset if the entity retains such an option and the transferee cannot readily obtain the transferred asset in the market if the entity exercises its option. [IFRS 9 Par. B3.2.7, IPSAS 29 AG57]

AG20. The transferee has the practical ability to sell the transferred asset only if the transferee can sell the transferred asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without imposing additional restrictions on the transfer. The critical question is what the transferee is able to do in practice, not what contractual rights the transferee has concerning what it can do with the transferred asset or what contractual prohibitions exist. In particular:

- (a) ~~a~~A contractual right to dispose of the transferred asset has little practical effect if there is no market for the transferred asset, and
- (b) ~~a~~An ability to dispose of the transferred asset has little practical effect if it cannot be exercised freely. For that reason:
 - (i) ~~t~~The transferee's ability to dispose of the transferred asset must be independent of the actions of others (i.e., it must be a unilateral ability~~); and~~;
 - (ii) ~~t~~The transferee must be able to dispose of the transferred asset without needing to attach restrictive conditions or "strings" to the transfer (e.g., conditions about how a loan asset is serviced or an option giving the transferee the right to repurchase the asset). [IFRS 9 Par. B3.2.8, IPSAS 29 AG58]

AG21. That the transferee is unlikely to sell the transferred asset does not, of itself, mean that the transferor has retained control of the transferred asset. However, if a put option or guarantee constrains the transferee from selling the transferred asset, then the transferor has retained control of the transferred asset. For example, if a put option or guarantee is sufficiently valuable it constrains the transferee from selling the transferred asset because the transferee would, in practice, not sell the transferred asset to a third party without attaching a similar option or other restrictive conditions. Instead, the transferee would hold the transferred asset so as to obtain payments under the guarantee or put option. Under these circumstances the transferor has retained control of the transferred asset. [IFRS 9 Par. B3.2.9, IPSAS 29 AG59]

Transfers that qualify for derecognition

AG22. An entity may retain the right to a part of the interest payments on transferred assets as compensation for servicing those assets. The part of the interest payments that the entity would give up upon termination or transfer of the servicing contract is allocated to the servicing asset or servicing liability. The part of the interest payments that the entity would not give up is an interest-only strip receivable. For example, if the entity would not give up any interest upon termination or transfer of the servicing contract, the entire interest spread is an interest-only strip receivable. For the purposes of applying paragraph 23~~3.2.13~~, the fair values of the servicing asset and interest-only strip receivable are used to allocate the carrying amount of

the receivable between the part of the asset that is ~~derecognised~~derecognized and the part that continues to be ~~recognised~~recognized. If there is no servicing fee specified or the fee to be received is not expected to compensate the entity adequately for performing the servicing, a liability for the servicing obligation is ~~recognised~~recognized at fair value. [IFRS 9 Par. B3.2.10, IPSAS 29 AG60]

- AG23. When measuring the fair values of the part that continues to be ~~recognised~~recognized and the part that is ~~derecognised~~derecognized for the purposes of applying paragraph 23~~3.2.13~~, an entity applies the fair value measurement requirements in ~~paragraphs 63– 65~~IFRS 13 Fair Value Measurement in addition to paragraph 3.2.14 and AG131–AG143. [IFRS 9 Par. B3.2.11, IPSAS 29 AG61]

Transfers that do not qualify for derecognition

- AG24. The following is an application of the principle outlined in paragraph 25~~3.2.15~~. If a guarantee provided by the entity for default losses on the transferred asset prevents a transferred asset from being ~~derecognised~~derecognized because the entity has retained substantially all the risks and rewards of ownership of the transferred asset, the transferred asset continues to be ~~recognised~~recognized in its entirety and the consideration received is ~~recognised~~recognized as a liability. [IFRS 9 Par. B3.2.12, IPSAS 29 AG62]

Continuing involvement in transferred assets

- AG25. The following are examples of how an entity measures a transferred asset and the associated liability under paragraph 26~~3.2.16~~. [IFRS 9 Par. B3.2.13, IPSAS 29 AG 63]

All assets

- (a) If a guarantee provided by an entity to pay for default losses on a transferred asset prevents the transferred asset from being ~~derecognised~~derecognized to the extent of the continuing involvement, the transferred asset at the date of the transfer is measured at the lower of (i) the carrying amount of the asset and (ii) the maximum amount of the consideration received in the transfer that the entity could be required to repay ('the guarantee amount'). The associated liability is initially measured at the guarantee amount plus the fair value of the guarantee (which is normally the consideration received for the guarantee). Subsequently, the initial fair value of the guarantee is ~~recognised~~recognized in ~~profit or loss~~surplus or deficit on a time proportion basis (see IPSAS 9) when (or as) the obligation is satisfied (in accordance with the principles of IFRS 15) and the carrying value of the asset is reduced by any loss allowance. [IFRS 9 Par. B3.2.13 a), IPSAS 29 AG 63 a)]

Assets measured at ~~amortised~~amortized cost

- (b) If a put option obligation written by an entity or call option right held by an entity prevents a transferred asset from being ~~derecognised~~derecognized and the entity measures the transferred asset at ~~amortised~~amortized cost, the associated liability is measured at its cost (i.e., the consideration received) adjusted for the ~~amortisation~~amortization of any difference between that cost and the gross carrying amount of the transferred asset at the expiration date of the option. For example, assume that the gross carrying amount of the asset on the date of the transfer is CU98 and that the consideration received is CU95. The gross carrying amount of the asset on the option exercise date will be CU100. The initial carrying amount of the associated liability is CU95 and the difference between CU95 and CU100 is ~~recognised~~recognized in ~~profit or loss~~surplus or deficit using the effective interest method. If the option is exercised, any difference

between the carrying amount of the associated liability and the exercise price is ~~recognised~~recognized in ~~profit or loss~~surplus or deficit. [IFRS 9 Par. B3.2.13 b), IPSAS 29 AG 63 b)]

Assets measured at fair value

- (c) If a call option right retained by an entity prevents a transferred asset from being ~~derecognised~~derecognized and the entity measures the transferred asset at fair value, the asset continues to be measured at its fair value. The associated liability is measured at (i) the option exercise price less the time value of the option if the option is in or at the money, or (ii) the fair value of the transferred asset less the time value of the option if the option is out of the money. The adjustment to the measurement of the associated liability ensures that the net carrying amount of the asset and the associated liability is the fair value of the call option right. For example, if the fair value of the underlying asset is CU80, the option exercise price is CU95 and the time value of the option is CU5, the carrying amount of the associated liability is CU75 (CU80 – CU5) and the carrying amount of the transferred asset is CU80 (ie its fair value). [IFRS 9 Par. B3.2.13 c), IPSAS 29 AG 63 c)]
- (d) If a put option written by an entity prevents a transferred asset from being ~~derecognised~~derecognized and the entity measures the transferred asset at fair value, the associated liability is measured at the option exercise price plus the time value of the option. The measurement of the asset at fair value is limited to the lower of the fair value and the option exercise price because the entity has no right to increases in the fair value of the transferred asset above the exercise price of the option. This ensures that the net carrying amount of the asset and the associated liability is the fair value of the put option obligation. For example, if the fair value of the underlying asset is CU120, the option exercise price is CU100 and the time value of the option is CU5, the carrying amount of the associated liability is CU105 (CU100 + CU5) and the carrying amount of the asset is CU100 (in this case the option exercise price). [IFRS 9 Par. B3.2.13 d), IPSAS 29 AG 63 d)]
- (e) If a collar, in the form of a purchased call and written put, prevents a transferred asset from being ~~derecognised~~derecognized and the entity measures the asset at fair value, it continues to measure the asset at fair value. The associated liability is measured at (i) the sum of the call exercise price and fair value of the put option less the time value of the call option, if the call option is in or at the money, or (ii) the sum of the fair value of the asset and the fair value of the put option less the time value of the call option if the call option is out of the money. The adjustment to the associated liability ensures that the net carrying amount of the asset and the associated liability is the fair value of the options held and written by the entity. For example, assume an entity transfers a financial asset that is measured at fair value while simultaneously purchasing a call with an exercise price of CU120 and writing a put with an exercise price of CU80. Assume also that the fair value of the asset is CU100 at the date of the transfer. The time value of the put and call are CU1 and CU5 respectively. In this case, the entity ~~recognises~~recognizes an asset of CU100 (the fair value of the asset) and a liability of CU96 [(CU100 + CU1) – CU5]. This gives a net asset value of CU4, which is the fair value of the options held and written by the entity. [IFRS 9 Par. B3.2.13, IPSAS 29 AG 63]

All transfers

- AG26. To the extent that a transfer of a financial asset does not qualify for derecognition, the transferor's contractual rights or obligations related to the transfer are not accounted for separately as derivatives if ~~recognising~~recognizing both the derivative and either the transferred asset or the liability arising from the transfer would result in ~~recognising~~recognizing the same

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rights or obligations twice. For example, a call option retained by the transferor may prevent a transfer of financial assets from being accounted for as a sale. In that case, the call option is not separately ~~recognised~~recognized as a derivative asset. [IFRS 9 Par. B3.2.14, IPSAS 29 AG64]

AG27. To the extent that a transfer of a financial asset does not qualify for derecognition, the transferee does not ~~recognise~~recognize the transferred asset as its asset. The transferee ~~derecognise~~derecognizes the cash or other consideration paid and ~~recognise~~recognizes a receivable from the transferor. If the transferor has both a right and an obligation to reacquire control of the entire transferred asset for a fixed amount (such as under a repurchase agreement), the transferee may measure its receivable at ~~amortised~~amortized cost if it meets the criteria in paragraph 38~~4.1.2~~. [IFRS 9 Par. B3.2.15, IPSAS 29 AG65]

Examples

AG28. The following examples illustrate the application of the derecognition principles of this Standard.

- (a) Repurchase agreements and securities lending. If a financial asset is sold under an agreement to repurchase it at a fixed price or at the sale price plus a lender's return or if it is loaned under an agreement to return it to the transferor, it is not ~~derecognised~~derecognized because the transferor retains substantially all the risks and rewards of ownership. If the transferee obtains the right to sell or pledge the asset, the transferor reclassifies the asset in its statement of financial position, for example, as a loaned asset or repurchase receivable. [IFRS 9 Par. B3.2.16a), IPSAS 29 AG 66a)]
- (b) Repurchase agreements and securities lending—assets that are substantially the same. If a financial asset is sold under an agreement to repurchase the same or substantially the same asset at a fixed price or at the sale price plus a lender's return or if a financial asset is borrowed or loaned under an agreement to return the same or substantially the same asset to the transferor, it is not ~~derecognised~~derecognized because the transferor retains substantially all the risks and rewards of ownership. [IFRS 9 Par. B3.2.16b), IPSAS 29 AG 66b)]
- (c) Repurchase agreements and securities lending—right of substitution. If a repurchase agreement at a fixed repurchase price or a price equal to the sale price plus a lender's return, or a similar securities lending transaction, provides the transferee with a right to substitute assets that are similar and of equal fair value to the transferred asset at the repurchase date, the asset sold or lent under a repurchase or securities lending transaction is not ~~derecognised~~derecognized because the transferor retains substantially all the risks and rewards of ownership. [IFRS 9 Par. B3.2.16c), IPSAS 29 AG 66c)]
- (d) Repurchase right of first refusal at fair value. If an entity sells a financial asset and retains only a right of first refusal to repurchase the transferred asset at fair value if the transferee subsequently sells it, the entity ~~derecognise~~derecognizes the asset because it has transferred substantially all the risks and rewards of ownership. [IFRS 9 Par. B3.2.16d), IPSAS 29 AG 66d)]
- (e) Wash sale transaction. The repurchase of a financial asset shortly after it has been sold is sometimes referred to as a wash sale. Such a repurchase does not preclude derecognition provided that the original transaction met the derecognition requirements. However, if an agreement to sell a financial asset is entered into concurrently with an agreement to repurchase the same asset at a fixed price or the sale price plus a lender's return, then the asset is not ~~derecognised~~derecognized. [IFRS 9 Par. B3.2.16e), IPSAS 29 AG 66e)]
- (f) Put options and call options that are deeply in the money. If a transferred financial asset can be called back by the transferor and the call option is deeply in the money, the transfer does not

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qualify for derecognition because the transferor has retained substantially all the risks and rewards of ownership. Similarly, if the financial asset can be put back by the transferee and the put option is deeply in the money, the transfer does not qualify for derecognition because the transferor has retained substantially all the risks and rewards of ownership. [IFRS 9 Par. B3.2.16f), IPSAS 29 AG 66f)]

- (g) Put options and call options that are deeply out of the money. A financial asset that is transferred subject only to a deep out-of-the-money put option held by the transferee or a deep out-of-the-money call option held by the transferor is ~~derecognised~~derecognized. This is because the transferor has transferred substantially all the risks and rewards of ownership. [IFRS 9 Par. B3.2.16g), IPSAS 29 AG 66g)]
- (h) Readily obtainable assets subject to a call option that is neither deeply in the money nor deeply out of the money. If an entity holds a call option on an asset that is readily obtainable in the market and the option is neither deeply in the money nor deeply out of the money, the asset is ~~derecognised~~derecognized. This is because the entity (i) has neither retained nor transferred substantially all the risks and rewards of ownership, and (ii) has not retained control. However, if the asset is not readily obtainable in the market, derecognition is precluded to the extent of the amount of the asset that is subject to the call option because the entity has retained control of the asset. [IFRS 9 Par. B3.2.16h), IPSAS 29 AG 66h)]
- (i) A not readily obtainable asset subject to a put option written by an entity that is neither deeply in the money nor deeply out of the money. If an entity transfers a financial asset that is not readily obtainable in the market, and writes a put option that is not deeply out of the money, the entity neither retains nor transfers substantially all the risks and rewards of ownership because of the written put option. The entity retains control of the asset if the put option is sufficiently valuable to prevent the transferee from selling the asset, in which case the asset continues to be ~~recognised~~recognized to the extent of the transferor's continuing involvement (see paragraph AG21B3.2.9). The entity transfers control of the asset if the put option is not sufficiently valuable to prevent the transferee from selling the asset, in which case the asset is ~~derecognised~~derecognized. [IFRS 9 Par. B3.2.16 i), IPSAS 29 AG 66 i)]
- (j) Assets subject to a fair value put or call option or a forward repurchase agreement. A transfer of a financial asset that is subject only to a put or call option or a forward repurchase agreement that has an exercise or repurchase price equal to the fair value of the financial asset at the time of repurchase results in derecognition because of the transfer of substantially all the risks and rewards of ownership. [IFRS 9 Par. B3.2.16 j), IPSAS 29 AG 66 j)]
- (k) Cash-settled call or put options. An entity evaluates the transfer of a financial asset that is subject to a put or call option or a forward repurchase agreement that will be settled net in cash to determine whether it has retained or transferred substantially all the risks and rewards of ownership. If the entity has not retained substantially all the risks and rewards of ownership of the transferred asset, it determines whether it has retained control of the transferred asset. That the put or the call or the forward repurchase agreement is settled net in cash does not automatically mean that the entity has transferred control (see paragraphs AG21B3.2.9 and (g), (h) and (i) above). [IFRS 9 Par. B3.2.16 k), IPSAS 29 AG 66 k)]
- (l) Removal of accounts provision. A removal of accounts provision is an unconditional repurchase (call) option that gives an entity the right to reclaim assets transferred subject to some restrictions. Provided that such an option results in the entity neither retaining nor transferring substantially all the risks and rewards of ownership, it precludes derecognition only to the extent of the amount subject to repurchase (assuming that the transferee cannot sell the assets). For example, if the

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carrying amount and proceeds from the transfer of loan assets are CU100,000 and any individual loan could be called back but the aggregate amount of loans that could be repurchased could not exceed CU10,000, CU90,000 of the loans would qualify for derecognition. [IFRS 9 Par. B3.2.16 l), IPSAS 29 AG 66 l)]

- (m) Clean-up calls. An entity, which may be a transferor, that services transferred assets may hold a clean-up call to purchase remaining transferred assets when the amount of outstanding assets falls to a specified level at which the cost of servicing those assets becomes burdensome in relation to the benefits of servicing. Provided that such a clean-up call results in the entity neither retaining nor transferring substantially all the risks and rewards of ownership and the transferee cannot sell the assets, it precludes derecognition only to the extent of the amount of the assets that is subject to the call option. [IFRS 9 Par. B3.2.16 m), IPSAS 29 AG 66 m)]
- (n) Subordinated retained interests and credit guarantees. An entity may provide the transferee with credit enhancement by subordinating some or all of its interest retained in the transferred asset. Alternatively, an entity may provide the transferee with credit enhancement in the form of a credit guarantee that could be unlimited or limited to a specified amount. If the entity retains substantially all the risks and rewards of ownership of the transferred asset, the asset continues to be ~~recognised~~recognized in its entirety. If the entity retains some, but not substantially all, of the risks and rewards of ownership and has retained control, derecognition is precluded to the extent of the amount of cash or other assets that the entity could be required to pay. [IFRS 9 Par. B3.2.16n), IPSAS 29 AG 66 n)]
- (o) Total return swaps. An entity may sell a financial asset to a transferee and enter into a total return swap with the transferee, whereby all of the interest payment cash flows from the underlying asset are remitted to the entity in exchange for a fixed payment or variable rate payment and any increases or declines in the fair value of the underlying asset are absorbed by the entity. In such a case, derecognition of all of the asset is prohibited. [IFRS 9 Par. B3.2.16 o), IPSAS 29 AG 66 o)]
- (p) Interest rate swaps. An entity may transfer to a transferee a fixed rate financial asset and enter into an interest rate swap with the transferee to receive a fixed interest rate and pay a variable interest rate based on a notional amount that is equal to the principal amount of the transferred financial asset. The interest rate swap does not preclude derecognition of the transferred asset provided the payments on the swap are not conditional on payments being made on the transferred asset. [IFRS 9 Par. B3.2.16p), IPSAS 29 AG 66p)]
- (q) ~~Amortising~~Amortizing interest rate swaps. An entity may transfer to a transferee a fixed rate financial asset that is paid off over time, and enter into an amortising interest rate swap with the transferee to receive a fixed interest rate and pay a variable interest rate based on a notional amount. If the notional amount of the swap amortises so that it equals the principal amount of the transferred financial asset outstanding at any point in time, the swap would generally result in the entity retaining substantial prepayment risk, in which case the entity either continues to ~~recognise~~recognize all of the transferred asset or continues to ~~recognise~~recognize the transferred asset to the extent of its continuing involvement. Conversely, if the ~~amortisation~~amortization of the notional amount of the swap is not linked to the principal amount outstanding of the transferred asset, such a swap would not result in the entity retaining prepayment risk on the asset. Hence, it would not preclude derecognition of the transferred asset provided the payments on the swap are not conditional on interest payments being made on the transferred asset and the swap does not result in the entity retaining any other significant risks and rewards of ownership on the transferred asset. [IFRS 9 Par. B3.2.16q), IPSAS 29 AG 66q)]

- (r) Write-off. An entity has no reasonable expectations of recovering the contractual cash flows on a financial asset in its entirety or a portion thereof. [IFRS 9 Par. B3.2.16 r), no IPSAS 29 equivalent paragraph]
- AG29. This paragraph illustrates the application of the continuing involvement approach when the entity's continuing involvement is in a part of a financial asset. [IFRS 9 Par. B3.2.17, IPSAS 29 AG67]

Assume an entity has a portfolio of prepayable loans whose coupon and effective interest rate is 10 per cent and whose principal amount and ~~amortised~~amortized cost is CU10,000. It enters into a transaction in which, in return for a payment of CU9,115, the transferee obtains the right to CU9,000 of any collections of principal plus interest thereon at 9.5 per cent. The entity retains rights to CU1,000 of any collections of principal plus interest thereon at 10 per cent, plus the excess spread of 0.5 per cent on the remaining CU9,000 of principal. Collections from prepayments are allocated between the entity and the transferee proportionately in the ratio of 1:9, but any defaults are deducted from the entity's interest of CU1,000 until that interest is exhausted. The fair value of the loans at the date of the transaction is CU10,100 and the estimated fair value of the excess spread of 0.5 per cent is CU40.

The entity determines that it has transferred some significant risks and rewards of ownership (for example, significant prepayment risk) but has also retained some significant risks and rewards of ownership (because of its subordinated retained interest) and has retained control. It therefore applies the continuing involvement approach.

To apply this Standard, the entity ~~analyse~~analyzes the transaction as (a) a retention of a fully proportionate retained interest of CU1,000, plus (b) the subordination of that retained interest to provide credit enhancement to the transferee for credit losses.

The entity calculates that CU9,090 (90% × CU10,100) of the consideration received of CU9,115 represents the consideration for a fully proportionate 90 per cent share. The remainder of the consideration received (CU25) represents consideration received for subordinating its retained interest to provide credit enhancement to the transferee for credit losses. In addition, the excess spread of 0.5 per cent represents consideration received for the credit enhancement. Accordingly, the total consideration received for the credit enhancement is CU65 (CU25 + CU40).

The entity calculates the gain or loss on the sale of the 90 per cent share of cash flows. Assuming that separate fair values of the 90 per cent part transferred and the 10 per cent part retained are not available at the date of the transfer, the entity allocates the carrying amount of the asset in accordance with paragraph 3.2.14 of IFRS 9 as follows:

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	<u>Estimated</u> f Fair value	Percentage	Allocated carrying amount
Portion transferred	9,090	90%	9,000
Portion retained	1,010	10%	1,000
Total	10,100		10,000

The entity computes its gain or loss on the sale of the 90 per cent share of the cash flows by deducting the allocated carrying amount of the portion transferred from the consideration received, ie CU90 (CU9,090 – CU9,000). The carrying amount of the portion retained by the entity is CU1,000.

In addition, the entity ~~recognises~~recognizes the continuing involvement that results from the subordination of its retained interest for credit losses. Accordingly, it ~~recognises~~recognizes an asset of CU1,000 (the maximum amount of the cash flows it would not receive under the subordination), and an associated liability of CU1,065 (which is the maximum amount of the cash flows it would not receive under the subordination, ie CU1,000 plus the fair value of the subordination of CU65).

The entity uses all of the above information to account for the transaction as follows:

	Debit	Credit
Original asset	—	9,000
Asset recognised <u>recognized</u> for subordination or the residual interest	1,000	—
Asset for the consideration received in the form of excess spread	40	—
Profit or loss <u>Surplus or deficit</u> (gain on transfer)	—	90
Liability	—	1,065
Cash received	9,115	—
Total	10,155	10,155

Immediately following the transaction, the carrying amount of the asset is CU2,040 comprising CU1,000, representing the allocated cost of the portion retained, and CU1,040, representing the entity's additional continuing involvement from the subordination of its retained interest for credit losses (which includes the excess spread of CU40).

In subsequent periods, the entity ~~recognises~~recognizes the consideration received for the credit enhancement (CU65) on a time proportion basis, accrues interest on the ~~recognised~~recognized asset using the effective interest method and ~~recognises~~recognizes any impairment losses on the ~~recognised~~recognized assets. As an example of the latter, assume that in the following year there is an impairment loss on the underlying loans of CU300. The entity reduces its ~~recognised~~recognized asset by CU600 (CU300 relating to its retained interest and CU300 relating to the additional continuing involvement that arises from the subordination of its retained interest for impairment losses), and reduces its ~~recognised~~recognized liability by CU300. The net result is a charge to ~~profit or loss~~surplus or deficit for impairment losses of CU300.

Derecognition of financial liabilities

AG30. A financial liability (or part of it) is extinguished when the debtor either:

- (a) ~~d~~Discharges the liability (or part of it) by paying the creditor, normally with cash, other financial assets, goods or services; or
- (b) ~~i~~s legally released from primary responsibility for the liability (or part of it) either by process of law or by the creditor. (If the debtor has given a guarantee this condition may still be met.) [IFRS 9 Par. B3.3.1, IPSAS 29 AG 72]

AG31. If an issuer of a debt instrument repurchases that instrument, the debt is extinguished even if the issuer is a market maker in that instrument or intends to resell it in the near term. [IFRS 9 Par. B3.3.2, IPSAS 29 AG73]

AG32. Payment to a third party, including a trust (sometimes called 'in-substance defeasance'), does not, by itself, relieve the debtor of its primary obligation to the creditor, in the absence of legal release. [IFRS 9 Par. B3.3.3, IPSAS 29 AG74]

AG33. If a debtor pays a third party to assume an obligation and notifies its creditor that the third party has assumed its debt obligation, the debtor does not ~~derecognise~~derecognize the debt obligation unless the condition in paragraph AG30(b)~~B3.3.1(b)~~ is met. If the debtor pays a third party to assume an obligation and obtains a legal release from its creditor, the debtor has extinguished the debt. However, if the debtor agrees to make payments on the debt to the third party or direct to its original creditor, the debtor ~~recognises~~recognizes a new debt obligation to the third party. [IFRS B3.3.4, IPSAS 29 AG75]

AG33-AG34. If a third party assumes an obligation of an entity, and the entity provides either no or only nominal consideration to that third party in return, an entity applies the derecognition requirements of this Standard as well as paragraphs 84 to 87 of IPSAS 23. [No IFRS 9 equivalent paragraph, IPSAS 29 AG76]

AG34-AG35. Lenders will sometimes waive their right to collect debt owed by a public sector entity, for example, a national government may cancel a loan owed by a local government. This waiver of debt would constitute a legal release of the debt owing by the borrower to the lender. Where an entity's obligations have been waived as part of a non-exchange transaction it applies the derecognition requirements of this Standard as well as paragraphs 84 to 87 of IPSAS 23. [No IFRS 9 equivalent paragraph, IPSAS 29 AG77]

AG35-AG36. Although legal release, whether judicially or by the creditor, results in derecognition of a liability, the entity may ~~recognises~~recognize a new liability if the derecognition criteria in paragraphs ~~11-3.2.1-33.2.23~~ are not met for the financial assets transferred. If those criteria are not met, the transferred assets are not ~~derecognised~~derecognized, and the entity

~~recognise~~recognizes a new liability relating to the transferred assets. [IFRS 9 Par. B3.3.5, IPSAS 29 AG 78]

~~AG36-AG37.~~ For the purpose of paragraph 35-~~3.3.2~~, 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 per cent 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~~recognized 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~~amortized over the remaining term of the modified liability. [IFRS 9 Par. B3.3.6, IPSAS 29 AG79]

~~AG37-AG38.~~ In some cases, a creditor releases a debtor from its present obligation to make payments, but the debtor assumes a guarantee obligation to pay if the party assuming primary responsibility defaults. In these circumstances the debtor:

- (a) ~~recognise~~Recognizes a new financial liability based on the fair value of its obligation for the guarantee-~~i~~ and
- (b) ~~recognise~~Recognizes a gain or loss based on the difference between (i) any proceeds paid and (ii) the carrying amount of the original financial liability less the fair value of the new financial liability. [IFRS 9 Par. B3.3.7 IPSAS 29 AG 80]

Classification

Classification of financial assets

The entity's ~~business model~~management model for ~~managing~~ financial assets

~~AG38-AG39.~~ Paragraph 38(a)~~4.1.1(a)~~ requires an entity to classify financial assets on the basis of the entity's ~~business model~~management model for ~~managing~~ the financial assets, unless paragraph 43~~4.1.5~~ applies. An entity assesses whether its financial assets meet the condition in paragraph 39(a)~~4.1.2(a)~~ or the condition in paragraph 40(a)~~4.1.2A(a)~~ on the basis of the ~~business model~~management model as determined by the entity's key management personnel (as defined in ~~IAS 24~~IPSAS 20 Related Party Disclosures). [IFRS 9 Par. B4.1.1]

~~AG39-AG40.~~ An entity's ~~business model~~management model is determined at a level that reflects how groups of financial assets are managed together to achieve a particular ~~business~~ objective. The entity's ~~business model~~management model does not depend on management's ~~intention~~management models 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 ~~business model~~management model for ~~managing~~ 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 ~~realise~~realize fair value changes. Similarly, in some circumstances, it may be appropriate to separate a portfolio of financial assets into subportfolios 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. [IFRS 9 Par. B4.1.2]

AG40-AG41. An entity's ~~business model~~management model refers to how an entity manages its financial assets in order to generate cash flows. That is, the entity's ~~business model~~management model determines whether cash flows will result from collecting contractual cash flows, selling financial assets or both. Consequently, this assessment is not performed on the basis of scenarios that the entity does not reasonably expect to occur, such as so-called 'worst case' or 'stress case' scenarios. For example, if an entity expects that it will sell a particular portfolio of financial assets only in a stress case scenario, that scenario would not affect the entity's assessment of the ~~business model~~management model for those assets if the entity reasonably expects that such a scenario will not occur. If cash flows are ~~realised~~realized in a way that is different from the entity's expectations at the date that the entity assessed the ~~business model~~management model (for example, if the entity sells more or fewer financial assets than it expected when it classified the assets), that does not give rise to a prior period error in the entity's financial statements (see ~~IAS 8~~IPSAS 3 Accounting Policies, Changes in Accounting Estimates and Errors) nor does it change the classification of the remaining financial assets held ~~in-with~~ that ~~business model~~management model (i.e., those assets that the entity ~~recognised~~recognized in prior periods and still holds) as long as the entity considered all relevant information that was available at the time that it made the ~~business model~~management model assessment. However, when an entity assesses the ~~business model~~management model for newly originated or newly purchased financial assets, it must consider information about how cash flows were ~~realised~~realized in the past, along with all other relevant information. [IFRS 9 Par. B4.1.2A]

AG41-AG42. An entity's ~~business model~~management model for ~~managing~~ financial assets is a matter of fact and not merely an assertion. It is typically observable through the activities that the entity undertakes to achieve the objective of the ~~business model~~management model. An entity will need to use ~~judgement~~judgment when it assesses its ~~business model~~management model for ~~managing~~ financial assets and that assessment is not determined by a single factor or activity. Instead, the entity must consider all relevant evidence that is available at the date of the assessment. Such relevant evidence includes, but is not limited to:

- (a) ~~How~~ the performance of the ~~business model~~management model and the financial assets held within that ~~business model~~management model are evaluated and reported to the entity's key management personnel;
- (b) ~~The~~ risks that affect the performance of the ~~business model~~management model (and the financial assets held within that ~~business model~~management model) and, in particular, the way in which those risks are managed; and
- (c) ~~How managers of the business are~~management is compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected). [IFRS 9 Par. B4.1.2B]

A ~~business model~~management model whose objective is to hold assets in order to collect contractual cash flows

AG42-AG43. Financial assets that are held within a ~~business model~~management model whose objective is to hold assets in order to collect contractual cash flows are managed to ~~realise~~realize cash flows by collecting contractual payments over the life of the instrument. That is, the entity manages the assets held within the portfolio to collect those particular contractual cash flows (instead of managing the overall return on the portfolio by both holding and selling assets). In determining whether cash flows are going to be ~~realised~~realized by collecting the financial assets' contractual cash flows, it is necessary to consider the frequency, value and

timing of sales in prior periods, the reasons for those sales and expectations about future sales activity. However sales in themselves do not determine the ~~business model~~management model and therefore cannot be considered in isolation. Instead, information about past sales and expectations about future sales provide evidence related to how the entity's stated objective for managing the financial assets is achieved and, specifically, how cash flows are ~~realised~~realized. An entity must consider information about past sales within the context of the reasons for those sales and the conditions that existed at that time as compared to current conditions. [IFRS 9 Par. B4.1.2C]

~~AG43-AG44.~~ Although the objective of an entity's ~~business model~~management model may be to hold financial assets in order to collect contractual cash flows, the entity need not hold all of those instruments until maturity. Thus an entity's ~~business model~~management model can be to hold financial assets to collect contractual cash flows even when sales of financial assets occur or are expected to occur in the future. [IFRS B4.1.3]

~~AG44-AG45.~~ The ~~business model~~management model may be to hold assets to collect contractual cash flows even if the entity sells financial assets when there is an increase in the assets' credit risk. To determine whether there has been an increase in the assets' credit risk, the entity considers reasonable and supportable information, including forward looking information. Irrespective of their frequency and value, sales due to an increase in the assets' credit risk are not inconsistent with a ~~business model~~management model whose objective is to hold financial assets to collect contractual cash flows because the credit quality of financial assets is relevant to the entity's ability to collect contractual cash flows. Credit risk management activities that are aimed at ~~minimising~~minimizing potential credit losses due to credit deterioration are integral to such a ~~business model~~management model. Selling a financial asset because it no longer meets the credit criteria specified in the entity's documented investment policy is an example of a sale that has occurred due to an increase in credit risk. However, in the absence of such a policy, the entity may demonstrate in other ways that the sale occurred due to an increase in credit risk. [IFRS 9 Par. B4.1.3A]

~~AG45-AG46.~~ Sales that occur for other reasons, such as sales made to manage credit concentration risk (without an increase in the assets' credit risk), may also be consistent with a ~~business model~~management model whose objective is to hold financial assets in order to collect contractual cash flows. In particular, such sales may be consistent with a ~~business model~~management model whose objective is to hold financial assets in order to collect contractual cash flows if those sales are infrequent (even if significant in value) or insignificant in value both individually and in aggregate (even if frequent). If more than an infrequent number of such sales are made out of a portfolio and those sales are more than insignificant in value (either individually or in aggregate), the entity needs to assess whether and how such sales are consistent with an objective of collecting contractual cash flows. Whether a third party imposes the requirement to sell the financial assets, or that activity is at the entity's discretion, is not relevant to this assessment. An increase in the frequency or value of sales in a particular period is not necessarily inconsistent with an objective to hold financial assets in order to collect contractual cash flows, if an entity can explain the reasons for those sales and demonstrate why those sales do not reflect a change in the entity's ~~business model~~management model. In addition, sales may be consistent with the objective of holding financial assets in order to collect contractual cash flows if the sales are made close to the maturity of the financial assets and the proceeds from the sales approximate the collection of the remaining contractual cash flows. [IFRS 9 Par. B4.1.3B]

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~~AG46-AG47.~~ The following are examples of when the objective of an entity's ~~business model~~management model may be to hold financial assets to collect the contractual cash flows. This list of examples is not exhaustive. Furthermore, the examples are not intended to discuss all factors that may be relevant to the assessment of the entity's ~~business model~~management model nor specify the relative importance of the factors. [IFRS 9 Par. B4.1.4]

Example	Analysis
<p>Example 1</p> <p>An entity holds investments to collect their contractual cash flows. The funding needs of the entity are predictable and the maturity of its financial assets is matched to the entity's estimated funding needs.</p> <p>The entity performs credit risk management activities with the objective of minimising<u>minimizing</u> credit losses. In the past, sales have typically occurred when the financial assets' credit risk has increased such that the assets no longer meet the credit criteria specified in the entity's documented investment policy. In addition, infrequent sales have occurred as a result of unanticipated funding needs.</p> <p>Reports to key management personnel focus on the credit quality of the financial assets and the contractual return. The entity also monitors fair values of the financial assets, among other information.</p>	<p>Although the entity considers, among other information, the financial assets' fair values from a liquidity perspective (i.e., the cash amount that would be realised<u>realized</u> if the entity needs to sell assets), the entity's objective is to hold the financial assets in order to collect the contractual cash flows. Sales would not contradict that objective if they were in response to an increase in the assets' credit risk, for example if the assets no longer meet the credit criteria specified in the entity's documented investment policy. Infrequent sales resulting from unanticipated funding needs (e.g., in a stress case scenario) also would not contradict that objective, even if such sales are significant in value.</p>
<p>Example 2</p> <p>An entity's business model<u>management model</u> is to purchase portfolios of financial assets, such as loans. Those portfolios may or may not include financial assets that are credit impaired. If payment on the loans is not made on a timely basis, the entity attempts to realise<u>realize</u> the contractual cash flows through various means—for example, by contacting the debtor by mail, telephone or other methods. The entity's objective is to collect the contractual cash flows and the entity does not manage any of the loans in this portfolio with an objective of realising<u>realizing</u> cash flows by selling them.</p> <p>In some cases, the entity enters into interest rate swaps to change the interest rate on particular financial assets in a portfolio from a floating interest rate to a fixed interest rate.</p>	<p>The objective of the entity's business model<u>management model</u> is to hold the financial assets in order to collect the contractual cash flows.</p> <p>The same analysis would apply even if the entity does not expect to receive all of the contractual cash flows (e.g., some of the financial assets are credit impaired at initial recognition).</p> <p>Moreover, the fact that the entity enters into derivatives to modify the cash flows of the portfolio does not in itself change the entity's business—model<u>management model</u>.</p>

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Example	Analysis
<p>Example 3</p> <p>An entity has a business model<u>management model</u> with the objective of originating <u>student</u> loans to customers or service recipients and subsequently selling those loans to a securitisation<u>securitization</u> vehicle. The securitisation<u>securitization</u> vehicle issues instruments to investors.</p> <p>The originating entity controls the securitisation<u>securitization</u> vehicle and thus consolidates it.</p> <p>The securitisation<u>securitization</u> vehicle collects the contractual cash flows from the loans and passes them on to its investors.</p> <p>It is assumed for the purposes of this example that the loans continue to be recognised<u>recognized</u> in the consolidated statement of financial position because they are not derecognised<u>derecognized</u> by the securitisation<u>securitization</u> vehicle.</p>	<p>The consolidated group<u>economic entity</u> originated the loans with the objective of holding them to collect the contractual cash flows.</p> <p>However, the originating entity has an objective of realising<u>realizing</u> cash flows on the loan portfolio by selling the loans to the securitisation<u>securitization</u> vehicle, so for the purposes of its separate financial statements it would not be considered to be managing this portfolio in order to collect the contractual cash flows.</p>

Example	Analysis
<p>Example 4</p> <p>A financial institutionlocal government entity that issues government bonds holds financial assets to meet liquidityredemption needs in a 'stress case' scenario (e.g., a run on the bank's government's depositsissued securities). The entity does not anticipate selling these assets except in such scenarios.</p> <p>The entity monitors the credit quality of the financial assets and its objective in managing the financial assets is to collect the contractual cash flows. The entity evaluates the performance of the assets on the basis of interest revenue earned and credit losses realisedrealized.</p> <p>However, the entity also monitors the fair value of the financial assets from a liquidity perspective to ensure that the cash amount that would be realisedrealized if the entity needed to sell the assets in a stress case scenario would be sufficient to meet the entity's liquidity needs. Periodically, the entity makes sales that are insignificant in value to demonstrate liquidity.</p>	<p>The objective of the entity's business modelmanagement model is to hold the financial assets to collect contractual cash flows.</p> <p>The analysis would not change even if during a previous stress case scenario the entity had sales that were significant in value in order to meet its liquidityredemption needs. Similarly, recurring sales activity that is insignificant in value is not inconsistent with holding financial assets to collect contractual cash flows.</p> <p>In contrast, if an entity holds financial assets to meet its everyday liquidityredemption needs and meeting that objective involves frequent sales that are significant in value, the objective of the entity's business modelmanagement model is not to hold the financial assets to collect contractual cash flows.</p> <p>Similarly, if the entity is required by its regulatorlaw or regulation to routinely sell financial assets to demonstrate that the assets are liquid, and the value of the assets sold is significant, the entity's business modelmanagement model is not to hold financial assets to collect contractual cash flows. Whether a third party imposes the requirement to sell the financial assets, or that activity is at the entity's discretion, is not relevant to the analysis.</p>

A ~~business model~~management model whose objective is achieved by both collecting contractual cash flows and selling financial assets

AG47-AG48. An entity may hold financial assets in a ~~business model~~management model whose objective is achieved by both collecting contractual cash flows and selling financial assets. In this type of ~~business model~~management model, the entity's key management personnel have made a decision that both collecting contractual cash flows and selling financial assets are integral to achieving the objective of the ~~business model~~management model. There are various objectives that may be consistent with this type of ~~business model~~management model. For example, the objective of the ~~business model~~management model may be to manage everyday liquidity needs, to maintain a particular interest yield profile or to match the duration of the financial assets to the duration of the liabilities that those assets are funding. To achieve such

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an objective, the entity will both collect contractual cash flows and sell financial assets. [IFRS 9 Par. B4.1.4A]

~~AG48-AG49.~~ Compared to a ~~business model management model~~ whose objective is to hold financial assets to collect contractual cash flows, this ~~business model management model~~ will typically involve greater frequency and value of sales. This is because selling financial assets is integral to achieving the ~~business model management model~~'s objective instead of being only incidental to it. However, there is no threshold for the frequency or value of sales that must occur in this ~~business model management model~~ because both collecting contractual cash flows and selling financial assets are integral to achieving its objective. [IFRS 9 Par. B4.1.4B]

~~AG49-AG50.~~ The following are examples of when the objective of the entity's ~~business model management model~~ may be achieved by both collecting contractual cash flows and selling financial assets. This list of examples is not exhaustive. Furthermore, the examples are not intended to describe all the factors that may be relevant to the assessment of the entity's ~~business model management model~~ nor specify the relative importance of the factors. [IFRS 9 Par. B4.1.4C]

Example	Analysis
<p>Example 5</p> <p>An entity anticipates capital expenditure in a few years. The entity invests its excess cash in short and long-term financial assets so that it can fund the expenditure when the need arises. Many of the financial assets have contractual lives that exceed the entity's anticipated investment period.</p> <p>The entity will hold financial assets to collect the contractual cash flows and, when an opportunity arises, it will sell financial assets to re-invest the cash in financial assets with a higher return.</p> <p>The managers responsible for the portfolio are remunerated based on the overall return generated by the portfolio.</p>	<p>The objective of the business model management model is achieved by both collecting contractual cash flows and selling financial assets. The entity will make decisions on an ongoing basis about whether collecting contractual cash flows or selling financial assets will maximize the return on the portfolio until the need arises for the invested cash.</p> <p>In contrast, consider an entity that anticipates a cash outflow in five years to fund capital expenditure and invests excess cash in short-term financial assets. When the investments mature, the entity reinvests the cash in new short-term financial assets. The entity maintains this strategy until the funds are needed, at which time the entity uses the proceeds from the maturing financial assets to fund the capital expenditure. Only sales that are insignificant in value occur before maturity (unless there is an increase in credit risk). The objective of this contrasting business model management model is to hold financial assets to collect contractual cash flows.</p>

Example	Analysis
<p>Example 6</p> <p>An <u>financial institution entity</u> holds financial assets to meet its everyday liquidity needs. The entity seeks to <u>minimise-minimize</u> the costs of managing those liquidity needs and therefore actively manages the return on the portfolio. That return consists of collecting contractual payments as well as gains and losses from the sale of financial assets.</p> <p>As a result, the entity holds financial assets to collect contractual cash flows and sells financial assets to reinvest in higher yielding financial assets or to better match the duration of its liabilities. In the past, this strategy has resulted in frequent sales activity and such sales have been significant in value. This activity is expected to continue in the future.</p>	<p>The objective of the <u>business modelmanagement model</u> is to <u>maximise maximize</u> the return on the portfolio to meet everyday liquidity needs and the entity achieves that objective by both collecting contractual cash flows and selling financial assets. In other words, both collecting contractual cash flows and selling financial assets are integral to achieving the <u>business modelmanagement model's</u> objective.</p>
<p>Example 7</p> <p>An <u>insurer social security fund</u> holds financial assets in order to fund <u>insurance contractsocial security</u> liabilities. The <u>fund insurer</u> uses the proceeds from the contractual cash flows on the financial assets to settle <u>insurance contractsocial security</u> liabilities as they come due. To ensure that the contractual cash flows from the financial assets are sufficient to settle those liabilities, the <u>insurer-fund</u> undertakes significant buying and selling activity on a regular basis to rebalance its portfolio of assets and to meet cash flow needs as they arise.</p>	<p>The objective of the <u>business modelmanagement model</u> is to fund the <u>insurance contractsocial security</u> liabilities. To achieve this objective, the entity collects contractual cash flows as they come due and sells financial assets to maintain the desired profile of the asset portfolio. Thus both collecting contractual cash flows and selling financial assets are integral to achieving the <u>business modelmanagement model's</u> objective.</p>

Other business modelmanagement models

AG50-AG51. Financial assets are measured at fair value through profit or loss surplus or deficit if they are not held within a business modelmanagement model whose objective is to hold assets to collect contractual cash flows or within a business modelmanagement model whose objective is achieved by both collecting contractual cash flows and selling financial assets (but see also paragraph 1025.7.5). One business modelmanagement model that results in measurement at fair value through profit or loss surplus or deficit is one in which an entity manages the financial assets with the objective of realisingrealizing cash flows through the sale of the assets. The entity makes decisions based on the assets' fair values and manages the assets to realise realize those fair values. In this case, the entity's objective will typically result in active buying and selling. Even though the entity will collect contractual cash flows while it holds the financial

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assets, the objective of such a ~~business model management model~~ is not achieved by both collecting contractual cash flows and selling financial assets. This is because the collection of contractual cash flows is not integral to achieving the ~~business model management model~~'s objective; instead, it is incidental to it. [IFRS 9 Par. B4.1.5]

~~AG51-AG52.~~ A portfolio of financial assets that is managed and whose performance is evaluated on a fair value basis (as described in paragraph 45(b)~~4.2.2(b)~~) is neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets. The entity is primarily focused on fair value information and uses that information to assess the assets' performance and to make decisions. In addition, a portfolio of financial assets that meets the definition of held for trading is not held to collect contractual cash flows or held both to collect contractual cash flows and to sell financial assets. For such portfolios, the collection of contractual cash flows is only incidental to achieving the ~~business model management model~~'s objective. Consequently, such portfolios of financial assets must be measured at fair value through ~~profit or loss~~surplus or deficit. [IFRS 9 Par. B4.1.6]

Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding

~~AG52-AG53.~~ Paragraph 38(b)~~4.1.1(b)~~ requires an entity to classify a financial asset on the basis of its contractual cash flow characteristics if the financial asset is held within a ~~business model management model~~ whose objective is to hold assets to collect contractual cash flows or within a ~~business model management model~~ whose objective is achieved by both collecting contractual cash flows and selling financial assets, unless paragraph 43~~4.1.5~~ applies. To do so, the condition in paragraphs 39(b)~~4.1.2(b)~~ and 40(b)~~4.1.2A(b)~~ requires an entity to determine whether the asset's contractual cash flows are solely payments of principal and interest on the principal amount outstanding. [IFRS B4.1.7]

~~AG53-AG54.~~ Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding are consistent with a basic lending arrangement. In a basic lending arrangement, consideration for the time value of money (see paragraphs AG58~~B4.1.9A~~–AG62~~B4.1.9E~~) 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 or commodity prices, 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. [IFRS 9 Par. B4.1.7A]

~~AG54-AG55.~~ In accordance with paragraph 41(a)~~4.1.3(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). [IFRS 9 Par. B4.1.7B]

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~~AG55-AG56.~~ An entity shall assess whether contractual cash flows are solely payments of principal and interest on the principal amount outstanding for the currency in which the financial asset is denominated. [IFRS 9 Par. B4.1.8]

~~AG56-AG57.~~ Leverage is a contractual cash flow characteristic of some financial assets. Leverage increases the variability of the contractual cash flows with the result that they do not have the economic characteristics of interest. Stand-alone option, forward and swap contracts are examples of financial assets that include such leverage. Thus, such contracts do not meet the condition in paragraphs 39(b)~~4.1.2(b)~~ and 40(b)~~4.1.2A(b)~~ and cannot be subsequently measured at ~~amortised~~amortized cost or fair value through ~~other comprehensive income~~net assets/equity. [IFRS 9 Par. B4.1.9]

Consideration for the time value of money

~~AG57-AG58.~~ Time value of money is the element of interest that provides consideration for only the passage of time. That is, the time value of money element does not provide consideration for other risks or costs associated with holding the financial asset. In order to assess whether the element provides consideration for only the passage of time, an entity applies ~~judgement~~judgment and considers relevant factors such as the currency in which the financial asset is denominated and the period for which the interest rate is set. [IFRS 9 Par. B4.1.9A]

~~AG58-AG59.~~ However, in some cases, the time value of money element may be modified (i.e., imperfect). That would be the case, for example, if a financial asset's interest rate is periodically reset but the frequency of that reset does not match the tenor of the interest rate (for example, the interest rate resets every month to a one-year rate) or if a financial asset's interest rate is periodically reset to an average of particular short- and long-term interest rates. In such cases, an entity must assess the modification to determine whether the contractual cash flows represent solely payments of principal and interest on the principal amount outstanding. In some circumstances, the entity may be able to make that determination by performing a qualitative assessment of the time value of money element whereas, in other circumstances, it may be necessary to perform a quantitative assessment. [IFRS 9 Par. B4.1.9B]

~~AG59-AG60.~~ When assessing a modified time value of money element, the objective is to determine how different the contractual (undiscounted) cash flows could be from the (undiscounted) cash flows that would arise if the time value of money element was not modified (the benchmark cash flows). For example, if the financial asset under assessment contains a variable interest rate that is reset every month to a one-year interest rate, the entity would compare that financial asset to a financial instrument with identical contractual terms and the identical credit risk except the variable interest rate is reset monthly to a one-month interest rate. If the modified time value of money element could result in contractual (undiscounted) cash flows that are significantly different from the (undiscounted) benchmark cash flows, the financial asset does not meet the condition in paragraphs 39(b)~~4.1.2(b)~~ and 40(b)~~4.1.2A(b)~~. To make this determination, the entity must consider the effect of the modified time value of money element in each reporting period and cumulatively over the life of the financial instrument. The reason for the interest rate being set in this way is not relevant to the analysis. If it is clear, with little or no analysis, whether the contractual (undiscounted) cash flows on the financial asset under the assessment could (or could not) be significantly different from the (undiscounted) benchmark cash flows, an entity need not perform a detailed assessment. [IFRS 9 Par. B4.1.9C]

~~AG60-AG61.~~ ——— When assessing a modified time value of money element, an entity must consider factors that could affect future contractual cash flows. For example, if an entity is assessing a bond with a five-year term and the variable interest rate is reset every six months

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to a five-year rate, the entity cannot conclude that the contractual cash flows are solely payments of principal and interest on the principal amount outstanding simply because the interest rate curve at the time of the assessment is such that the difference between a five-year interest rate and a six-month interest rate is not significant. Instead, the entity must also consider whether the relationship between the five-year interest rate and the six-month interest rate could change over the life of the instrument such that the contractual (undiscounted) cash flows over the life of the instrument could be significantly different from the (undiscounted) benchmark cash flows. However, an entity must consider only reasonably possible scenarios instead of every possible scenario. If an entity concludes that the contractual (undiscounted) cash flows could be significantly different from the (undiscounted) benchmark cash flows, the financial asset does not meet the condition in paragraphs 39(b) ~~4.1.2(b)~~ and 40(b) ~~4.1.2A(b)~~ and therefore cannot be measured at ~~amortised~~ amortized cost or fair value through ~~other comprehensive income~~ net assets/equity. [IFRS 9 Par. B4.1.9D]

~~AG61-AG62.~~ In some jurisdictions, the government or a regulatory authority sets interest rates. For example, such government regulation of interest rates may be part of a broad macroeconomic policy or it may be introduced to encourage entities to invest in a particular sector of the economy. In some of these cases, the objective of the time value of money element is not to provide consideration for only the passage of time. However, despite paragraphs AG58 ~~B4.1.9A-57B4.1.9D~~, a regulated interest rate shall be considered a proxy for the time value of money element for the purpose of applying the condition in paragraphs 39(b) ~~4.1.2(b)~~ and 40(b) ~~4.1.2A(b)~~ if that regulated interest rate provides consideration that is broadly consistent with the passage of time and does not provide exposure to risks or volatility in the contractual cash flows that are inconsistent with a basic lending arrangement. [IFRS 9 Par. B4.1.9E]

Contractual terms that change the timing or amount of contractual cash flows

~~AG62-AG63.~~ If a financial asset contains a contractual term that could change the timing or amount of contractual cash flows (for example, if the asset can be prepaid before maturity or its term can be extended), the entity must determine whether the contractual cash flows that could arise over the life of the instrument due to that contractual term are solely payments of principal and interest on the principal amount outstanding. To make this determination, the entity must assess the contractual cash flows that could arise both before, and after, the change in contractual cash flows. The entity may also need to assess the nature of any contingent event (i.e. the trigger) that would change the timing or amount of the contractual cash flows. While the nature of the contingent event in itself is not a determinative factor in assessing whether the contractual cash flows are solely payments of principal and interest, it may be an indicator. For example, compare a financial instrument with an interest rate that is reset to a higher rate if the debtor misses a particular number of payments to a financial instrument with an interest rate that is reset to a higher rate if a specified equity index reaches a particular level. It is more likely in the former case that the contractual cash flows over the life of the instrument will be solely payments of principal and interest on the principal amount outstanding because of the relationship between missed payments and an increase in credit risk. (See also paragraph AG71 ~~B4.1.18.~~) [IFRS 9 Par. B4.1.10]

~~AG63-AG64.~~ The following are examples of contractual terms that result in contractual cash flows that are solely payments of principal and interest on the principal amount outstanding:

- (a) ~~a~~ A variable interest rate that consists of consideration for the time value of money, the credit risk associated with the principal amount outstanding during a particular period of time (the

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consideration for credit risk may be determined at initial recognition only, and so may be fixed) and other basic lending risks and costs, as well as a profit margin;

- (b) ~~a~~A contractual term that permits the issuer (i.e. the debtor) to prepay a debt instrument or permits the holder (i.e. the creditor) to put a debt instrument back to the issuer before maturity and the prepayment amount substantially represents unpaid amounts of principal and interest on the principal amount outstanding, which may include reasonable additional compensation for the early termination of the contract; and
- (c) ~~a~~A contractual term that permits the issuer or the holder to extend the contractual term of a debt instrument (i.e. an extension option) and the terms of the extension option result in contractual cash flows during the extension period that are solely payments of principal and interest on the principal amount outstanding, which may include reasonable additional compensation for the extension of the contract. [IFRS 9 Par. B4.1.11]

~~AG64-AG65.~~ Despite paragraph AG63~~B4.1.10~~, a financial asset that would otherwise meet the condition in paragraphs 39(b)~~4.1.2(b)~~ and 40(b)~~4.1.2A(b)~~ but does not do so only as a result of a contractual term that permits (or requires) the issuer to prepay a debt instrument or permits (or requires) the holder to put a debt instrument back to the issuer before maturity is eligible to be measured at ~~amortised~~amortized cost or fair value through ~~other comprehensive income~~net assets/equity (subject to meeting the condition in paragraph 39(a)~~4.1.2(a)~~ or the condition in paragraph 40(a)~~4.1.2A(a)~~) if:

- (a) ~~T~~he entity acquires or originates the financial asset at a premium or discount to the contractual par amount;
- (b) ~~t~~he prepayment amount substantially represents the contractual par amount and accrued (but unpaid) contractual interest, which may include reasonable additional compensation for the early termination of the contract; and
- (c) ~~W~~hen the entity initially ~~recognise~~recognizes the financial asset, the fair value of the prepayment feature is insignificant. [IFRS 9 Par. B4.1.12]

~~AG65-AG66.~~ The following examples illustrate contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. This list of examples is not exhaustive. [IFRS 9 Par. B4.1.13]

Instrument	Analysis
<p>Instrument A</p> <p>Instrument A is a bond with a stated maturity date. Payments of principal and interest on the principal amount outstanding are linked to an inflation index of the currency in which the instrument is issued. The inflation link is not leveraged and the principal is protected.</p>	<p>The contractual cash flows are solely payments of principal and interest on the principal amount outstanding. Linking payments of principal and interest on the principal amount outstanding to an unleveraged inflation index resets the time value of money to a current level. In other words, the interest rate on the instrument reflects 'real' interest. Thus, the interest amounts are consideration for the time value of money on the principal amount outstanding.</p> <p>However, if the interest payments were indexed to another variable such as the debtor's performance (e.g., the debtor's net income <u>revenue</u>) or an equity index, the contractual cash flows are not payments of principal and interest on the principal amount outstanding (unless the indexing to the debtor's performance results in an adjustment that only compensates the holder for changes in the credit risk of the instrument, such that contractual cash flows are solely payments of principal and interest). That is because the contractual cash flows reflect a return that is inconsistent with a basic lending arrangement (see paragraph AG54B4.1.7A).</p>

Instrument	Analysis
<p>Instrument B</p> <p>Instrument B is a variable interest rate instrument with a stated maturity date that permits the borrower to choose the market interest rate on an ongoing basis. For example, at each interest rate reset date, the borrower can choose to pay three-month <u>interbank offered rate</u>LIBOR for a three-month term or one-month <u>interbank offered rate</u>LIBOR for a one-month term.</p>	<p>The contractual cash flows are solely payments of principal and interest on the principal amount outstanding as long as the interest paid over the life of the instrument reflects consideration for the time value of money, for the credit risk associated with the instrument and for other basic lending risks and costs, as well as a profit margin (see paragraph AG54B4.1.7A). The fact that the <u>interbank offered rate</u>LIBOR interest rate is reset during the life of the instrument does not in itself disqualify the instrument.</p> <p>However, if the borrower is able to choose to pay a one-month interest rate that is reset every three months, the interest rate is reset with a frequency that does not match the tenor of the interest rate. Consequently, the time value of money element is modified. Similarly, if an instrument has a contractual interest rate that is based on a term that can exceed the instrument's remaining life (for example, if an instrument with a five-year maturity pays a variable rate that is reset periodically but always reflects a five-year maturity), the time value of money element is modified. That is because the interest payable in each period is disconnected from the interest period.</p> <p>In such cases, the entity must qualitatively or quantitatively assess the contractual cash flows against those on an instrument that is identical in all respects except the tenor of the interest rate matches the interest period to determine if the cash flows are solely payments of principal and interest on the principal amount outstanding. (But see paragraph AG62B4.1.9E for guidance on regulated interest rates.)</p>

Instrument	Analysis
	<p>For example, in assessing a bond with a five-year term that pays a variable rate that is reset every six months but always reflects a five-year maturity, an entity considers the contractual cash flows on an instrument that resets every six months to a six-month interest rate but is otherwise identical.</p> <p>The same analysis would apply if the borrower is able to choose between the lender's various published interest rates (e.g. the borrower can choose between the lender's published one-month variable interest rate and the lender's published three-month variable interest rate).</p>
<p>Instrument C</p> <p>Instrument C is a bond with a stated maturity date and pays a variable market interest rate. That variable interest rate is capped.</p>	<p>The contractual cash flows of both:</p> <ul style="list-style-type: none"> (a) an instrument that has a fixed interest rate and (b) an instrument that has a variable interest rate <p>are payments of principal and interest on the principal amount outstanding as long as the interest reflects consideration for the time value of money, for the credit risk associated with the instrument during the term of the instrument and for other basic lending risks and costs, as well as a profit margin. (See paragraph AG54B4.1.7A)</p> <p>Consequently, an instrument that is a combination of (a) and (b) (e.g. a bond with an interest rate cap) can have cash flows that are solely payments of principal and interest on the principal amount outstanding. Such a contractual term may reduce cash flow variability by setting a limit on a variable interest rate (eg an interest rate cap or floor) or increase the cash flow variability because a fixed rate becomes variable.</p>
<p>Instrument D</p> <p>Instrument D is a full recourse loan and is secured by collateral.</p>	<p>The fact that a full recourse loan is collateralised does not in itself affect the analysis of whether the contractual cash flows are solely payments of principal and interest on the principal amount outstanding.</p>

Instrument	Analysis
<p>Instrument E</p> <p>Instrument E is issued by a regulated bank and has a stated maturity date. The instrument pays a fixed interest rate and all contractual cash flows are non-discretionary.</p> <p>However, the issuer is subject to legislation that permits or requires a national resolving authority to impose losses on holders of particular instruments, including Instrument E, in particular circumstances. For example, the national resolving authority has the power to write down the par amount of Instrument E or to convert it into a fixed number of the issuer's ordinary shares if the national resolving authority determines that the issuer is having severe financial difficulties, needs additional regulatory capital or is 'failing'.</p>	<p>The holder would analyse<u>analyze</u> the contractual terms of the financial instrument to determine whether they give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding and thus are consistent with a basic lending arrangement.</p> <p>That analysis would not consider the payments that arise only as a result of the national resolving authority's power to impose losses on the holders of Instrument E. That is because that power, and the resulting payments, are not contractual terms of the financial instrument.</p> <p>In contrast, the contractual cash flows would not be solely payments of principal and interest on the principal amount outstanding if the contractual terms of the financial instrument permit or require the issuer or another entity to impose losses on the holder (e.g., by writing down the par amount or by converting the instrument into a fixed number of the issuer's ordinary shares) as long as those contractual terms are genuine, even if the probability is remote that such a loss will be imposed.</p>

~~AG66~~AG67. The following examples illustrate contractual cash flows that are not solely payments of principal and interest on the principal amount outstanding. This list of examples is not exhaustive. [IFRS B4.1.14]

Instrument	Analysis
<p>Instrument F</p> <p>Instrument F is a bond that is convertible into a fixed number of equity instruments of the issuer.</p>	<p>The holder would analyse<u>analyze</u> the convertible bond in its entirety.</p> <p>The contractual cash flows are not payments of principal and interest on the principal amount outstanding because they reflect a return that is inconsistent with a basic lending arrangement (see paragraph AG54B4.1.7A); ie the return is linked to the value of the equity of the issuer.</p>

Instrument	Analysis
<p>Instrument G</p> <p>Instrument G is a loan that pays an inverse floating interest rate (i.e., the interest rate has an inverse relationship to market interest rates).</p>	<p>The contractual cash flows are not solely payments of principal and interest on the principal amount outstanding.</p> <p>The interest amounts are not consideration for the time value of money on the principal amount outstanding.</p>
<p>Instrument H</p> <p>Instrument H is a perpetual instrument but the issuer may call the instrument at any point and pay the holder the par amount plus accrued interest due.</p> <p>Instrument H pays a market interest rate but payment of interest cannot be made unless the issuer is able to remain solvent immediately afterwards.</p> <p>Deferred interest does not accrue additional interest.</p>	<p>The contractual cash flows are not payments of principal and interest on the principal amount outstanding. That is because the issuer may be required to defer interest payments and additional interest does not accrue on those deferred interest amounts. As a result, interest amounts are not consideration for the time value of money on the principal amount outstanding.</p> <p>If interest accrued on the deferred amounts, the contractual cash flows could be payments of principal and interest on the principal amount outstanding.</p> <p>The fact that Instrument H is perpetual does not in itself mean that the contractual cash flows are not payments of principal and interest on the principal amount outstanding. In effect, a perpetual instrument has continuous (multiple) extension options. Such options may result in contractual cash flows that are payments of principal and interest on the principal amount outstanding if interest payments are mandatory and must be paid in perpetuity.</p> <p>Also, the fact that Instrument H is callable does not mean that the contractual cash flows are not payments of principal and interest on the principal amount outstanding unless it is callable at an amount that does not substantially reflect payment of outstanding principal and interest on that principal amount outstanding. Even if the callable amount includes an amount that reasonably compensates the holder for the early termination of the instrument, the contractual cash flows could be payments of principal and interest on the principal amount outstanding.</p> <p>(See also paragraph AG65B4.1.12.)</p>

[AG67-AG68.](#) In some cases a financial asset may have contractual cash flows that are described as principal and interest but those cash flows do not represent the payment of principal and interest

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on the principal amount outstanding as described in paragraphs 39(b)~~4.1.2(b)~~, 40(b)~~4.1.2A(b)~~ and 41~~4.1.3~~ of this Standard. [IFRS 9 Par. B4.1.15]

~~AG68-AG69.~~ This may be the case if the financial asset represents an investment in particular assets or cash flows and hence the contractual cash flows are not solely payments of principal and interest on the principal amount outstanding. For example, if the contractual terms stipulate that the financial asset's cash flows increase as more automobiles use a particular toll road, those contractual cash flows are inconsistent with a basic lending arrangement. As a result, the instrument would not satisfy the condition in paragraphs 39(b)~~4.1.2(b)~~ and 40(b)~~4.1.2A(b)~~. This could be the case when a creditor's claim is limited to specified assets of the debtor or the cash flows from specified assets (for example, a 'non-recourse' financial asset). [IFRS 9 Par. B4.1.16]

~~AG69-AG70.~~ However, the fact that a financial asset is non-recourse does not in itself necessarily preclude the financial asset from meeting the condition in paragraphs 39(b)~~4.1.2(b)~~ and 40(b)~~4.1.2A(b)~~. In such situations, the creditor is required to assess ('look through to') the particular underlying assets or cash flows to determine whether the contractual cash flows of the financial asset being classified are payments of principal and interest on the principal amount outstanding. If the terms of the financial asset give rise to any other cash flows or limit the cash flows in a manner inconsistent with payments representing principal and interest, the financial asset does not meet the condition in paragraphs 39(b)~~4.1.2(b)~~ and 40(b)~~4.1.2A(b)~~. Whether the underlying assets are financial assets or non-financial assets does not in itself affect this assessment. [IFRS 9 Par. B4.1.17]

~~AG70-AG71.~~ A contractual cash flow characteristic does not affect the classification of the financial asset if it could have only a de minimis effect on the contractual cash flows of the financial asset. To make this determination, an entity must consider the possible effect of the contractual cash flow characteristic in each reporting period and cumulatively over the life of the financial instrument. In addition, if a contractual cash flow characteristic could have an effect on the contractual cash flows that is more than de minimis (either in a single reporting period or cumulatively) but that cash flow characteristic is not genuine, it does not affect the classification of a financial asset. A cash flow characteristic is not genuine if it affects the instrument's contractual cash flows only on the occurrence of an event that is extremely rare, highly abnormal and very unlikely to occur. [IFRS 9 Par. B4.1.18]

~~AG71-AG72.~~ In almost every lending transaction the creditor's instrument is ranked relative to the instruments of the debtor's other creditors. An instrument that is subordinated to other instruments may have contractual cash flows that are payments of principal and interest on the principal amount outstanding if the debtor's non-payment is a breach of contract and the holder has a contractual right to unpaid amounts of principal and interest on the principal amount outstanding even in the event of the debtor's bankruptcy. For example, a trade receivable that ranks its creditor as a general creditor would qualify as having payments of principal and interest on the principal amount outstanding. This is the case even if the debtor issued loans that are ~~collateralised~~~~collateralized~~, which in the event of bankruptcy would give that loan holder priority over the claims of the general creditor in respect of the collateral but does not affect the contractual right of the general creditor to unpaid principal and other amounts due. [IFRS 9 Par. B4.1.19]

Contractually linked instruments

~~AG72-AG73.~~ In some types of transactions, an issuer may ~~prioritise~~~~prioritize~~ payments to the holders of financial assets using multiple contractually linked instruments that create

concentrations of credit risk (tranches). Each tranche has a subordination ranking that specifies the order in which any cash flows generated by the issuer are allocated to the tranche. In such situations, the holders of a tranche have the right to payments of principal and interest on the principal amount outstanding only if the issuer generates sufficient cash flows to satisfy higher-ranking tranches. [IFRS 9 Par. B4.1.20]

~~AG73-AG74.~~ In such transactions, a tranche has cash flow characteristics that are payments of principal and interest on the principal amount outstanding only if:

- (a) ~~the~~ The contractual terms of the tranche being assessed for classification (without looking through to the underlying pool of financial instruments) give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding (e.g., the interest rate on the tranche is not linked to a commodity index);
- (b) ~~the~~ The underlying pool of financial instruments has the cash flow characteristics set out in paragraphs AG76~~B4.1.23~~ and AG77~~B4.1.24~~; and
- (c) ~~the~~ The exposure to credit risk in the underlying pool of financial instruments inherent in the tranche is equal to or lower than the exposure to credit risk of the underlying pool of financial instruments (for example, the credit rating of the tranche being assessed for classification is equal to or higher than the credit rating that would apply to a single tranche that funded the underlying pool of financial instruments). [IFRS 9 Par. B4.1.21]

~~AG74-AG75.~~ An entity must look through until it can identify the underlying pool of instruments that are creating (instead of passing through) the cash flows. This is the underlying pool of financial instruments. [IFRS 9 Par. B4.1.22]

~~AG75-AG76.~~ The underlying pool must contain one or more instruments that have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. [IFRS 9 Par. B4.1.23]

~~AG76-AG77.~~ The underlying pool of instruments may also include instruments that:

- (a) reduce the cash flow variability of the instruments in paragraph AG76~~B4.1.23~~ and, when combined with the instruments in paragraph AG76~~B4.1.23~~, result in cash flows that are solely payments of principal and interest on the principal amount outstanding (e.g., an interest rate cap or floor or a contract that reduces the credit risk on some or all of the instruments in paragraph AG76~~B4.1.23~~); or
- (b) align the cash flows of the tranches with the cash flows of the pool of underlying instruments in paragraph AG76~~B4.1.23~~ to address differences in and only in:
 - (i) ~~whether~~ Whether the interest rate is fixed or floating;
 - (ii) ~~the~~ The currency in which the cash flows are denominated, including inflation in that currency; or
 - (iii) ~~the~~ The timing of the cash flows. [IFRS 9 Par. B4.1.24]

~~AG77-AG78.~~ If any instrument in the pool does not meet the conditions in either paragraph AG76~~B4.1.23~~ or paragraph AG77~~B4.1.24~~, the condition in paragraph AG74(b)~~B4.1.21(b)~~ is not met. In performing this assessment, a detailed instrument-by-instrument analysis of the pool may not be necessary. However, an entity must use ~~judgement~~ judgment and perform sufficient analysis to determine whether the instruments in the pool meet the conditions in paragraphs AG76~~B4.1.23~~–AG77~~B4.1.24~~. (See also paragraph AG71~~B4.1.18~~ for guidance on contractual cash flow characteristics that have only a de minimis effect.) [IFRS 9 Par. B4.1.25]

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AG78-AG79. If the holder cannot assess the conditions in paragraph 73B4.1.21 at initial recognition, the tranche must be measured at fair value through ~~profit or loss~~surplus or deficit. If the underlying pool of instruments can change after initial recognition in such a way that the pool may not meet the conditions in paragraphs AG76B4.1.23–AG77B4.1.24, the tranche does not meet the conditions in paragraph 73B4.1.21 and must be measured at fair value through ~~profit or loss~~surplus or deficit. However, if the underlying pool includes instruments that are ~~collateralised~~collateralized by assets that do not meet the conditions in paragraphs AG76B4.1.23–AG77B4.1.24, the ability to take possession of such assets shall be disregarded for the purposes of applying this paragraph unless the entity acquired the tranche with the ~~intention~~management model of controlling the collateral. [IFRS 9 Par. B4.1.26]

Option to designate a financial asset or financial liability as at fair value through ~~profit or loss~~surplus or deficit

AG79-AG80. Subject to the conditions in paragraphs 434.1.5 and 454.2.2, this Standard allows an entity to designate a financial asset, a financial liability, or a group of financial instruments (financial assets, financial liabilities or both) as at fair value through ~~profit or loss~~surplus or deficit provided that doing so results in more relevant information. [IFRS 9 Par. B4.1.27, IPSAS 29 AG 7]

AG80-AG81. The decision of an entity to designate a financial asset or financial liability as at fair value through ~~profit or loss~~surplus or deficit is similar to an accounting policy choice (although, unlike an accounting policy choice, it is not required to be applied consistently to all similar transactions). When an entity has such a choice, paragraph 14(b)12 of IAS 8~~IPSAS 3~~ requires the chosen policy to result in the financial statements providing ~~reliable~~faithfully representative and more relevant information about the effects of transactions, other events and conditions on the entity's financial position, financial performance or cash flows. For example, in the case of designation of a financial liability as at fair value through ~~profit or loss~~surplus or deficit, paragraph 454.2.2 sets out the two circumstances when the requirement for more relevant information will be met. Accordingly, to choose such designation in accordance with paragraph 454.2.2, the entity needs to demonstrate that it falls within one (or both) of these two circumstances. [IFRS 9 Par. B4.1.28, IPSAS 29 AG8]

Designation eliminates or significantly reduces an accounting mismatch

AG81-AG82. Measurement of a financial asset or financial liability and classification of ~~recognised~~recognized changes in its value are determined by the item's classification and whether the item is part of a designated hedging relationship. Those requirements can create a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') when, for example, in the absence of designation as at fair value through ~~profit or loss~~surplus or deficit, a financial asset would be classified as subsequently measured at fair value through ~~profit or loss~~surplus or deficit and a liability the entity considers related would be subsequently measured at ~~amortised~~amortized cost (with changes in fair value not ~~recognised~~recognized). In such circumstances, an entity may conclude that its financial statements would provide more relevant information if both the asset and the liability were measured as at fair value through ~~profit or loss~~surplus or deficit. [IFRS 9 Par. B4.1.29, IPSAS 29 AG9]

AG82-AG83. The following examples show when this condition could be met. In all cases, an entity may use this condition to designate financial assets or financial liabilities as at fair value through ~~profit or loss~~surplus or deficit only if it meets the principle in paragraph 434.1.5 or 45(a)4.2.2(a):

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- (a) ~~a~~An entity has liabilities under insurance contracts whose measurement incorporates current information ~~(as permitted by paragraph 24 of IFRS 4)~~ and financial assets that it considers to be related and that would otherwise be measured at either fair value through ~~other comprehensive income~~ ~~net assets/equity~~ or ~~amortised~~ ~~amortized~~ cost.
- (b) ~~a~~An entity has financial assets, financial liabilities or both that share a risk, such as interest rate risk, and that gives rise to opposite changes in fair value that tend to offset each other. However, only some of the instruments would be measured at fair value through ~~profit or loss~~ ~~surplus or deficit~~ (for example, those that are derivatives, or are classified as held for trading). It may also be the case that the requirements for hedge accounting are not met because, for example, the requirements for hedge effectiveness in paragraph ~~XX6.4.4~~ are not met.
- (c) ~~a~~An entity has financial assets, financial liabilities or both that share a risk, such as interest rate risk, that gives rise to opposite changes in fair value that tend to offset each other and none of the financial assets or financial liabilities qualifies for designation as a hedging instrument because they are not measured at fair value through ~~profit or loss~~ ~~surplus or deficit~~. Furthermore, in the absence of hedge accounting there is a significant inconsistency in the recognition of gains and losses. For example, the entity has financed a specified group of loans by issuing traded bonds whose changes in fair value tend to offset each other. If, in addition, the entity regularly buys and sells the bonds but rarely, if ever, buys and sells the loans, reporting both the loans and the bonds at fair value through ~~profit or loss~~ ~~surplus or deficit~~ eliminates the inconsistency in the timing of the recognition of the gains and losses that would otherwise result from measuring them both at ~~amortised~~ ~~amortized~~ cost and ~~recognising~~ ~~recognizing~~ a gain or loss each time a bond is repurchased. [IFRS 9 Par. B4.1.30, IPSAs 29 AG10]

~~AG83-AG84.~~ In cases such as those described in the preceding paragraph, to designate, at initial recognition, the financial assets and financial liabilities not otherwise so measured as at fair value through ~~profit or loss~~ ~~surplus or deficit~~ may eliminate or significantly reduce the measurement or recognition inconsistency and produce more relevant information. For practical purposes, the entity need not enter into all of the assets and liabilities giving rise to the measurement or recognition inconsistency at exactly the same time. A reasonable delay is permitted provided that each transaction is designated as at fair value through ~~profit or loss~~ ~~surplus or deficit~~ at its initial recognition and, at that time, any remaining transactions are expected to occur. [IFRS 9 Par. B4.1.31, IPSAS 29 AG11]

~~AG84-AG85.~~ It would not be acceptable to designate only some of the financial assets and financial liabilities giving rise to the inconsistency as at fair value through ~~profit or loss~~ ~~surplus or deficit~~ if to do so would not eliminate or significantly reduce the inconsistency and would therefore not result in more relevant information. However, it would be acceptable to designate only some of a number of similar financial assets or similar financial liabilities if doing so achieves a significant reduction (and possibly a greater reduction than other allowable designations) in the inconsistency. For example, assume an entity has a number of similar financial liabilities that sum to CU100 and a number of similar financial assets that sum to CU50 but are measured on a different basis. The entity may significantly reduce the measurement inconsistency by designating at initial recognition all of the assets but only some of the liabilities (for example, individual liabilities with a combined total of CU45) as at fair value through ~~profit or loss~~ ~~surplus or deficit~~. However, because designation as at fair value through ~~profit or loss~~ ~~surplus or deficit~~ can be applied only to the whole of a financial instrument, the entity in this example must designate one or more liabilities in their entirety. It could not designate either a component of a liability (e.g., changes in value attributable to only one risk, such as changes in a benchmark

interest rate) or a proportion (i.e., percentage) of a liability. [IFRS 9 Par. B4.1.32, IPSAS 29 AG12]

A group of financial liabilities or financial assets and financial liabilities is managed and its performance is evaluated on a fair value basis

~~AG85-AG86.~~ An entity may manage and evaluate the performance of a group of financial liabilities or financial assets and financial liabilities in such a way that measuring that group at fair value through ~~profit or loss~~ surplus or deficit results in more relevant information. The focus in this instance is on the way the entity manages and evaluates performance, instead of on the nature of its financial instruments. [IFRS 9 Par. B4.1.33, IPSAS 29 AG13]

~~AG86-AG87.~~ For example, an entity may use this condition to designate financial liabilities as at fair value through ~~profit or loss~~ surplus or deficit if it meets the principle in paragraph 45(b) ~~4.2.2(b)~~ and the entity has financial assets and financial liabilities that share one or more risks and those risks are managed and evaluated on a fair value basis in accordance with a documented policy of asset and liability management. An example could be an entity that has issued 'structured products' containing multiple embedded derivatives and manages the resulting risks on a fair value basis using a mix of derivative and non-derivative financial instruments. [IFRS B4.1.34, IPSAS 29 AG14]

~~AG87-AG88.~~ As noted above, this condition relies on the way the entity manages and evaluates performance of the group of financial instruments under consideration. Accordingly, (subject to the requirement of designation at initial recognition) an ~~B~~ entity that designates financial liabilities as at fair value through ~~profit or loss~~ surplus or deficit on the basis of this condition shall so designate all eligible financial liabilities that are managed and evaluated together. [IFRS 9 Par. B4.1.35, IPSAS 29 AG15]

~~AG88-AG89.~~ Documentation of the entity's strategy need not be extensive but should be sufficient to demonstrate compliance with paragraph 45(b) ~~4.2.2(b)~~. Such documentation is not required for each individual item, but may be on a portfolio basis. For example, if the performance management system for a department—as approved by the entity's key management personnel—clearly demonstrates that its performance is evaluated on this basis, no further documentation is required to demonstrate compliance with paragraph 45(b) ~~4.2.2(b)~~. [IFRS 9 Par. B4.1.36, IPASS 29 AG 16]

Embedded derivatives

~~AG89-AG90.~~ When an entity becomes a party to a hybrid contract with a host that is not an asset within the scope of this Standard, paragraph 48 ~~4.3.3~~ requires the entity to identify any embedded derivative, assess whether it is required to be separated from the host contract and, for those that are required to be separated, measure the derivatives at fair value at initial recognition and subsequently at fair value through ~~profit or loss~~ surplus or deficit. [IFRS 9 Par. B4.3.1, IPSAS 29 AG 47]

~~AG90-AG91.~~ If a host contract has no stated or predetermined maturity and represents a residual interest in the net assets of an entity, then its economic characteristics and risks are those of an equity instrument, and an embedded derivative would need to possess equity characteristics related to the same entity to be regarded as closely related. If the host contract is not an equity instrument and meets the definition of a financial instrument, then its economic characteristics and risks are those of a debt instrument. [IFRS 9 Par. B4.3.2, IPSAS 29 AG40]

~~AG91-AG92.~~ An embedded non-option derivative (such as an embedded forward or swap) is separated from its host contract on the basis of its stated or implied substantive terms, so as to

result in it having a fair value of zero at initial recognition. An embedded option-based derivative (such as an embedded put, call, cap, floor or swaption) is separated from its host contract on the basis of the stated terms of the option feature. The initial carrying amount of the host instrument is the residual amount after separating the embedded derivative. [IFRS 9 Par. B4.3.3, IPSAS 29 AG41]

~~AG92~~-AG93. Generally, multiple embedded derivatives in a single hybrid contract are treated as a single compound embedded derivative. However, embedded derivatives that are classified as equity (see ~~IAS 32~~ IPSAS 28 *Financial Instruments: Presentation*) are accounted for separately from those classified as assets or liabilities. In addition, if a hybrid contract has more than one embedded derivative and those derivatives relate to different risk exposures and are readily separable and independent of each other, they are accounted for separately from each other. [IFRS 9 Par. B4.3.4, IPSAS 29 AG42]

~~AG93~~-AG94. The economic characteristics and risks of an embedded derivative are not closely related to the host contract (paragraph 48(a) ~~4.3.3(a)~~) in the following examples. In these examples, assuming the conditions in paragraph 48(b) ~~4.3.3(b)~~ and 48(c) ~~(c)~~ are met, an entity accounts for the embedded derivative separately from the host contract.

- (a) A put option embedded in an instrument that enables the holder to require the issuer to reacquire the instrument for an amount of cash or other assets that varies on the basis of the change in an equity or commodity price or index is not closely related to a host debt instrument. [IFRS 9 Par. B4.3.5 a), IPSAS 29 AG 43 a)]
- (b) An option or automatic provision to extend the remaining term to maturity of a debt instrument is not closely related to the host debt instrument unless there is a concurrent adjustment to the approximate current market rate of interest at the time of the extension. If an entity issues a debt instrument and the holder of that debt instrument writes a call option on the debt instrument to a third party, the issuer regards the call option as extending the term to maturity of the debt instrument provided the issuer can be required to participate in or facilitate the remarketing of the debt instrument as a result of the call option being exercised. [IFRS 9 Par. B4.3.5 b), IPSAS 29 AG 43 c)]
- (c) Equity-indexed interest or principal payments embedded in a host debt instrument or insurance contract—by which the amount of interest or principal is indexed to the value of equity instruments—are not closely related to the host instrument because the risks inherent in the host and the embedded derivative are dissimilar. [IFRS 9 Par. B4.3.5 c), IPSAS 29 AG 43 d)]
- (d) Commodity-indexed interest or principal payments embedded in a host debt instrument or insurance contract—by which the amount of interest or principal is indexed to the price of a commodity (such as gold)—are not closely related to the host instrument because the risks inherent in the host and the embedded derivative are dissimilar. [IFRS 9 Par. B4.3.5 d), IPSAS 29 AG 43 e)]
- (e) A call, put, or prepayment option embedded in a host debt contract or host insurance contract is not closely related to the host contract unless:
 - (i) ~~the~~ the option's exercise price is approximately equal on each exercise date to the ~~amortised~~ amortized cost of the host debt instrument or the carrying amount of the host insurance contract; or
 - (ii) ~~the~~ the exercise price of a prepayment option reimburses the lender for an amount up to the approximate present value of lost interest for the remaining term of the host contract. Lost interest is the product of the principal amount prepaid multiplied

by the interest rate differential. The interest rate differential is the excess of the effective interest rate of the host contract over the effective interest rate the entity would receive at the prepayment date if it reinvested the principal amount prepaid in a similar contract for the remaining term of the host contract.

The assessment of whether the call or put option is closely related to the host debt contract is made before separating the equity element of a convertible debt instrument in accordance with ~~IAS 32~~ IPSAS 28. [IFRS 9 Par. B4.3.5 e), IPSAS 29 AG 43 g)]

- (f) Credit derivatives that are embedded in a host debt instrument and allow one party (the 'beneficiary') to transfer the credit risk of a particular reference asset, which it may not own, to another party (the 'guarantor') are not closely related to the host debt instrument. Such credit derivatives allow the guarantor to assume the credit risk associated with the reference asset without directly owning it. [IFRS 9 Par. B4.3.5]

~~AG94-AG95.~~ An example of a hybrid contract is a financial instrument that gives the holder a right to put the financial instrument back to the issuer in exchange for an amount of cash or other financial assets that varies on the basis of the change in an equity or commodity index that may increase or decrease (a 'puttable instrument'). Unless the issuer on initial recognition designates the puttable instrument as a financial liability at fair value through ~~profit or loss~~ surplus or deficit, it is required to separate an embedded derivative (i.e., the indexed principal payment) under paragraph 484.3.3 because the host contract is a debt instrument under paragraph AG91B4.3.2 and the indexed principal payment is not closely related to a host debt instrument under paragraph AG94B4.3.5(a). Because the principal payment can increase and decrease, the embedded derivative is a non-option derivative whose value is indexed to the underlying variable. [IFRS 9 Par. B4.3.6, IPSAS 29 AG44]

~~AG95-AG96.~~ In the case of a puttable instrument that can be put back at any time for cash equal to a proportionate share of the net asset value of an entity (such as units of an open-ended mutual fund or some unit-linked investment products), the effect of separating an embedded derivative and accounting for each component is to measure the hybrid contract at the redemption amount that is payable at the end of the reporting period if the holder exercised its right to put the instrument back to the issuer. [IFRS 9 Par. B4.3.7, IPSAS 29 AG45]

~~AG96-AG97.~~ The economic characteristics and risks of an embedded derivative are closely related to the economic characteristics and risks of the host contract in the following examples. In these examples, an entity does not account for the embedded derivative separately from the host contract.

- (a) An embedded derivative in which the underlying is an interest rate or interest rate index that can change the amount of interest that would otherwise be paid or received on an interest-bearing host debt contract or insurance contract is closely related to the host contract unless the hybrid contract can be settled in such a way that the holder would not recover substantially all of its ~~recognised~~ recognized investment or the embedded derivative could at least double the holder's initial rate of return on the host contract and could result in a rate of return that is at least twice what the market return would be for a contract with the same terms as the host contract.
- (b) An embedded floor or cap on the interest rate on a debt contract or insurance contract is closely related to the host contract, provided the cap is at or above the market rate of interest and the floor is at or below the market rate of interest when the contract is issued, and the cap or floor is not leveraged in relation to the host contract. Similarly, provisions included in a contract to purchase or sell an asset (e.g., a commodity) that establish a cap and a floor on the price to be

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paid or received for the asset are closely related to the host contract if both the cap and floor were out of the money at inception and are not leveraged.

- (c) An embedded foreign currency derivative that provides a stream of principal or interest payments that are denominated in a foreign currency and is embedded in a host debt instrument (for example, a dual currency bond) is closely related to the host debt instrument. Such a derivative is not separated from the host instrument because ~~IAS 24~~[IPSAS 4](#) *The Effects of Changes in Foreign Exchange Rates* requires foreign currency gains and losses on monetary items to be ~~recognised~~[recognized](#) in ~~profit or loss~~[surplus or deficit](#).
- (d) An embedded foreign currency derivative in a host contract that is an insurance contract or not a financial instrument (such as a contract for the purchase or sale of a non-financial item where the price is denominated in a foreign currency) is closely related to the host contract provided it is not leveraged, does not contain an option feature, and requires payments denominated in one of the following currencies:
 - (i) ~~the~~[the](#) functional currency of any substantial party to that contract;
 - (ii) ~~the~~[the](#) currency in which the price of the related good or service that is acquired or delivered is routinely denominated in commercial transactions around the world (such as the US dollar for crude oil transactions); or
 - (iii) ~~a~~[a](#) currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place (e.g., a relatively stable and liquid currency that is commonly used in local business transactions or external trade).
- (e) An embedded prepayment option in an interest-only or principal-only strip is closely related to the host contract provided the host contract (i) initially resulted from separating the right to receive contractual cash flows of a financial instrument that, in and of itself, did not contain an embedded derivative, and (ii) does not contain any terms not present in the original host debt contract.
- (f) An embedded derivative in a host lease contract is closely related to the host contract if the embedded derivative is (i) an inflation-related index such as an index of lease payments to a consumer price index (provided that the lease is not leveraged and the index relates to inflation in the entity's own economic environment), (ii) variable lease payments based on related sales or (iii) variable lease payments based on variable interest rates.
- (g) A unit-linking feature embedded in a host financial instrument or host insurance contract is closely related to the host instrument or host contract if the unit-denominated payments are measured at current unit values that reflect the fair values of the assets of the fund. A unit-linking feature is a contractual term that requires payments denominated in units of an internal or external investment fund.
- (h) A derivative embedded in an insurance contract is closely related to the host insurance contract if the embedded derivative and host insurance contract are so interdependent that an entity cannot measure the embedded derivative separately (i.e., without considering the host contract).
[\[IFRS 9 Par. B4.3.8, IPSAS 29 AG46\]](#)

Instruments containing embedded derivatives

~~AG97~~[AG98](#). As noted in paragraph ~~AG90~~[B4.3.1](#), when an entity becomes a party to a hybrid contract with a host that is not an asset within the scope of this Standard and with one or more embedded derivatives, paragraph ~~484~~[3.3](#) requires the entity to identify any such embedded derivative, assess whether it is required to be separated from the host contract and, for those

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that are required to be separated, measure the derivatives at fair value at initial recognition and subsequently. These requirements can be more complex, or result in less reliable measures, than measuring the entire instrument at fair value through ~~profit or loss~~ surplus or deficit. For that reason this Standard permits the entire hybrid contract to be designated as at fair value through ~~profit or loss~~ surplus or deficit. [IFRS 9 Par. B4.3.9, IPSAS 29 AG47]

~~AG98-AG99.~~ Such designation may be used whether paragraph 48~~4.3.3~~ requires the embedded derivatives to be separated from the host contract or prohibits such separation. However, paragraph 50~~4.3.5~~ would not justify designating the hybrid contract as at fair value through ~~profit or loss~~ surplus or deficit in the cases set out in paragraph 50(a)~~4.3.5(a)~~ and 50(b)~~(b)~~ because doing so would not reduce complexity or increase reliability. [IFRS 9 Par. B4.3.10, IPSAS 29 AG48]

Reassessment of embedded derivatives

~~AG99-AG100.~~ In accordance with paragraph 48~~4.3.3~~, an entity shall assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required. An entity determines whether a modification to cash flows is significant by considering the extent to which the expected future cash flows associated with the embedded derivative, the host contract or both have changed and whether the change is significant relative to the previously expected cash flows on the contract. [IFRS 9 Par. B4.3.11, IPSAS 29 B5]

~~AG100-AG101.~~ Paragraph AG100~~B4.3.11~~ does not apply to embedded derivatives in contracts acquired in:

- (a) ~~a~~An ~~business entity~~ combination ~~(as defined in IFRS 3 Business Combinations)~~;
- (b) ~~a~~A combination of entities ~~or businesses~~ under common control ~~as described in paragraphs B1–B4 of IFRS 3~~; or
- (c) ~~t~~The formation of a joint venture as defined in ~~IFRS 11~~IPSAS 37 *Joint Arrangements*
~~o~~Or their possible reassessment at the date of acquisition. [IFRS 9 Par. B4.3.12, no equivalent paragraph under IPSAS 29]

Reclassification of financial assets

~~AG101-AG102.~~ Paragraph 53~~4.4.1~~ requires an entity to reclassify financial assets if the entity changes its ~~business model~~ management model for managing those financial assets. Such changes are expected to be very infrequent. Such changes are determined by the entity's senior management as a result of external or internal changes and must be significant to the entity's operations and demonstrable to external parties. Accordingly, a change in an entity's ~~business model~~ management model will occur only when an entity either begins or ceases to perform an activity that is significant to its operations; for example, when the entity has acquired, disposed of or terminated a business line. Examples of a change in ~~business model~~ management model include the following:

- (a) ~~An entity~~ government agency extends loans to small business owners and has a management model to sell the loan portfolios to private entities at a discount due the long collection cycle of these loans. has a portfolio of commercial loans that it holds to sell in the short term. The entity enters into a long term contract with a third party collection service provider, and the loan

~~portfolios are acquired by a company that manages commercial loans and has a business model that holds the loans in order to collect the contractual cash flows. The portfolio of commercial loans is no longer for sale, and the portfolio is now managed together with the acquired commercial loans and all are held to collect the contractual cash flows with the aid of the collections service provider.~~

- (b) ~~A financial services firm decides to shut down its retail mortgage business. That business no longer accepts new business and the financial services firm is actively marketing its mortgage loan portfolio for sale.~~ A department of government held a portfolio of longer term fixed income securities to collect cash flows in order to finance a planned infrastructure project in the foreseeable future. A change in the government's plan resulted in the cancellation of the project and the portfolio is grouped into the entity's regular investment portfolio that is regularly sold to meet its everyday liquidity needs in funding its various programs. [IFRS 9 Par. B4.4.1, no equivalent paragraph under IPSAS 29]

~~AG102-AG103.~~ A change in the objective of the entity's ~~business model~~management model must be effected before the reclassification date. For example, if a financial services firm decides on 15 February to shut down its retail mortgage business and hence must reclassify all affected financial assets on 1 April (ie the first day of the entity's next reporting period), the entity must not accept new retail mortgage business or otherwise engage in activities consistent with its former ~~business model~~management model after 15 February. [IFRS 9 Par. B4.4.2, no equivalent paragraph under IPSAS 29]

~~AG103-AG104.~~ The following are not changes in ~~business model~~management model:

- (a) ~~a~~A change in intention related to particular financial assets (even in circumstances of significant changes in market conditions).
- (b) ~~t~~The temporary disappearance of a particular market for financial assets.
- (c) ~~a~~A transfer of financial assets between parts of the entity with different ~~business model~~management models. [IFRS 9 Par. B4.4.3, no equivalent paragraph under IPSAS 29]

Measurement

Non-Exchange Revenue Transactions

AG105. The initial recognition and measurement of assets and liabilities resulting from non-exchange revenue transactions is dealt with in IPSAS 23. Assets resulting from non-exchange revenue transactions can arise out of both contractual and non-contractual arrangements (see IPSAS 28 paragraphs AG20 and AG21). Where these assets arise out of contractual arrangements and otherwise meet the definition of a financial instrument, they are:

- (a) Initially recognized in accordance with IPSAS 23;
- (b) Initially measured:
 - (i) At fair value using the principles in IPSAS 23; and
 - (ii) Taking account of transaction costs that are directly attributable to the acquisition of the financial asset in accordance with paragraph 56 of this Standard, where the asset is subsequently measured other than at fair value through surplus or deficit.

(See paragraphs IEXX to IEXX accompanying this Standard) [No IFRS 9 equivalent, IPSAS 23 AG81]

Initial measurement

~~AG104-AG106.~~ The fair value of a financial instrument at initial recognition is normally the transaction price (i.e., the fair value of the consideration given or received, see also paragraph AG1B5.1.2A and IFRS 13). 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 (see paragraphs AG136-AG142)~~an entity shall measure the fair value of the financial instrument.~~ For example, the fair value of a long-term loan or receivable that carries no interest can be measured as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating. Any additional amount lent is an expense or a reduction of ~~income~~revenue unless it qualifies for recognition as some other type of asset. [IFRS 9 Par. B5.1.1, IPSAS 29 AG82]

~~AG105-AG107.~~ If an entity originates a loan that bears an off-market interest rate (e.g., 5 per cent when the market rate for similar loans is 8 per cent), and receives an upfront fee as compensation, the entity ~~recognise~~recognizes the loan at its fair value, i.e., net of the fee it receives. [IFRS 9 Par. B5.1.2, IPSAS 29 AG83]

~~AG106.~~ The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price (ie the fair value of the consideration given or received, see also IFRS 13). If an entity determines that the fair value at initial recognition differs from the transaction price as mentioned in paragraph 575.1.1A, the entity shall account for that instrument at that date as follows:

- ~~(a) at the measurement required by paragraph 5.1.1 if that fair value is evidenced by a quoted price in an active market for an identical asset or liability (ie a Level 1 input) or based on a valuation technique that uses only data from observable markets. An entity shall recognise the difference between the fair value at initial recognition and the transaction price as a gain or loss.~~
- ~~(b) in all other cases, at the measurement required by paragraph 5.1.1, adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the entity shall recognise that deferred difference as a gain or loss only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the asset or liability. [IFRS 9 Par. B5.1.2A]~~

Concessionary Loans

AG108. Concessionary loans are granted to or received by an entity at 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. Entities may receive concessionary loans, for example, from development agencies and other government entities. [No IFRS equivalent, IPSAS 29 AG84]

AG109. 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. [No IFRS equivalent, IPSAS 29 AG85]

AG110. 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, a 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 IPSAS 29.

AG111. ~~[No IFRS equivalent, new public sector modification- See Note 49 above]~~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 analyzes the substance of the loan granted or received into its component parts, and accounts for those components using the principles in paragraphs AG112 and AG113 below. [No IFRS equivalent, IPSAS 29 AG87]

AG112. 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 IPSAS 28 and paragraphs 42–58 of IPSAS 23. 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 AG131–AG143. 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 (see AG106). [No IFRS equivalent, IPSAS 29 AG88]

AG113. 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 IPSAS 23.
- (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. [No IFRS equivalent, IPSAS 29 AG89]

Illustrative Examples are provided in paragraph IG54 of IPSAS 23 as well as paragraphs IEXX to IEXX accompanying this Standard.

AG114. After initial recognition, an entity subsequently measures concessionary loans in accordance with paragraphs 58–62. [No IFRS equivalent, IPSAS 29 AG90]

AG115. An originated credit-impaired financial asset (see paragraphs 82–83) is extended at market terms at inception, which distinguishes it from a concessionary loan which is granted or received at below market terms. [No IFRS equivalent, new public sector modification- See Note 49 above]

Equity Instruments Arising from Non-Exchange Transactions

AG116. In the public sector, equity investment can be used as a way for an entity to provide financing or subsidized funding to another public sector entity. In such a transaction, there is generally a lack of an active market for such investments (i.e. the equity instrument is unquoted), and there are no or minimal future cash flow expectations from the investment besides a potential redemption by the issuing entity. Cash is provided by the investing entity to the investee generally to further the investee's economic or social objectives. Examples of such investments

could include membership shares in a development bank, or equity investment in another public sector entity that provides certain social programs or services (e.g. shelters, subsidized housing, small business assistance...etc.) [No IFRS equivalent, new public sector modification]

AG117. At initial recognition of such transactions, an entity shall analyze the substance of the arrangement and assess whether the cash provided in full or in part, is in substance a grant, with the intention at the outset being provision or receipt of resources by way of a non-exchange transaction. To the extent that the transaction is a non-exchange transaction, any assets or revenues arising from the transaction are accounted for in accordance with IPSAS 23. The entity providing the grant shall recognize the amount as an expense in surplus or deficit at initial recognition. [No IFRS equivalent, new public sector modification]

AG118. To the extent an equity instrument arises from the transaction that is within the scope of this [draft] Standard, it is to be recognized initially at fair value in accordance with paragraph 56. The equity instrument is to be measured subsequently in accordance with paragraphs 58-60. If the instrument does not have an active market, the entity shall consider valuation techniques and inputs in AG136- AG143) in determining its fair value. [No IFRS equivalent, new public sector modification]

Valuing Financial Guarantees Issued Through a Non-Exchange Transaction

AG119. Only contractual financial guarantees (or guarantees that are in substance, contractual) are within the scope of this Standard (See AG3 and AG4 of IPSAS 28). Non-contractual guarantees are not within the scope of this Standard as they do not meet the definition of a financial instrument. This Standard prescribes recognition and measurement requirements only for the issuer of financial guarantee contracts. [No IFRS equivalent, IPSAS 29 AG92]

AG120. In Appendix 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 Standard, financial guarantee contracts, like other financial assets and financial liabilities, are required to be initially recognized at fair value. Paragraphs 63–64 of this Standard provide commentary and guidance on determining fair value and this is complemented by Application Guidance in paragraphs AG131–AG143. Subsequent measurement for financial guarantee contracts is at the higher of the amount of the loss allowance determined in accordance with paragraphs 70–89 and the amount initially recognized less, when appropriate, cumulative amortization in accordance with IPSAS 9, *Revenue from Exchange Transactions*. [No IFRS equivalent, IPSAS 29 AG93]

AG121. 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 recognize 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 paragraphs 70–89 and the amount initially recognized, less, when appropriate, cumulative amortization recognized in accordance with IPSAS 9. 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. [No IFRS equivalent, IPSAS 29 AG94]

AG122. 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. [No IFRS equivalent, IPSAS 29 AG95]

AG123. 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, National Government W guarantees a bond issue of Municipality X. As Municipality X 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 recognizes the financial guarantee at that fair value in the statement of financial position and recognizes 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. [No IFRS equivalent, IPSAS 29 AG96]

AG124. 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 IPSAS 19 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. [No IFRS equivalent, IPSAS 29 AG97]

Subsequent measurement

~~AG107~~-AG125. If a financial instrument that was previously ~~recognised~~ recognized as a financial asset is measured at fair value through ~~profit or loss~~ surplus or deficit and its fair value decreases below zero, it is a financial liability measured in accordance with paragraph 44.2.1. However, hybrid contracts with hosts that are assets within the scope of this Standard are always measured in accordance with paragraph 47.3.2. [IFRS 9 Par. B5.2.1, IPSAS 29 AG98]

~~AG108-AG126.~~ The following example illustrates the accounting for transaction costs on the initial and subsequent measurement of a financial asset measured at fair value with changes through ~~other comprehensive income~~ net assets/equity in accordance with either paragraph 1025.7.5 or 404.1.2A. An entity acquires a financial asset for CU100 plus a purchase commission of CU2. Initially, the entity ~~recognise~~ recognizes the asset at CU102. The reporting period ends one day later, when the quoted market price of the asset is CU100. If the asset were sold, a commission of CU3 would be paid. On that date, the entity measures the asset at CU100 (without regard to the possible commission on sale) and ~~recognise~~ recognizes a loss of CU2 in ~~other comprehensive income~~ net assets/equity. If the financial asset is measured at fair value through ~~other comprehensive income~~ net assets/equity in accordance with paragraph 404.1.2A, the transaction costs are ~~amortised~~ amortized to ~~profit or loss~~ surplus or deficit using the effective interest method. [IFRS 9 Par. B5.2.2, IPSAS 29 AG 99]

~~AG109. The subsequent measurement of a financial asset or financial liability and the subsequent recognition of gains and losses described in paragraph B5.1.2A shall be consistent with the requirements of this Standard. [IFRS 9 Par. B5.2.2A]~~

Investments in equity instruments and contracts on those investments

~~AG110-AG127.~~ All investments in equity instruments and contracts on those instruments must be measured at fair value. However, in limited circumstances, cost may be an appropriate estimate of fair value. That may be the case if insufficient more recent information is available to measure fair value, or if there is a wide range of possible fair value measurements and cost represents the best estimate of fair value within that range. [IFRS 9 Par. B5.2.3, no equivalent IPSAS 29]

~~AG111-AG128.~~ Indicators that cost might not be representative of fair value include:

- (a) ~~A~~ significant change in the performance of the investee compared with budgets, plans or milestones.
- (b) ~~e~~ Changes in expectation that the investee's technical product milestones will be achieved.
- (c) ~~a~~ significant change in the market for the investee's net assets/equity or its products or potential products.
- (d) ~~a~~ significant change in the global economy or the economic environment in which the investee operates.
- (e) ~~a~~ significant change in the performance of comparable entities, or in the valuations implied by the overall market.
- (f) ~~i~~ Internal matters of the investee such as fraud, commercial disputes, litigation, changes in management or strategy.

~~e~~ Evidence from external transactions in the investee's net assets/equity, either by the investee (such as a fresh issue of equity), or by transfers of equity instruments between third parties. [IFRS 9 Par. B5.2.4, no equivalent IPSAS 29 paragraph]

~~AG112-AG129.~~ The list in paragraph AG128 ~~B5.2.4~~ is not exhaustive. An entity shall use all information about the performance and operations of the investee that becomes available after the date of initial recognition. To the extent that any such relevant factors exist, they may indicate that cost might not be representative of fair value. In such cases, the entity must measure fair value. [IFRS 9 Par. B5.2.5, no equivalent IPSAS 29 paragraph]

~~AG113~~-AG130. Cost is never the best estimate of fair value for investments in quoted equity instruments (or contracts on quoted equity instruments). [IFRS 9 Par. B5.2.6, no equivalent IPSAS 29 paragraph]

Fair Value Measurement Considerations

AG131. Underlying the definition of fair value is a presumption that an entity is a going concern without any intention or need to liquidate, to curtail materially the scale of its operations or to undertake a transaction on adverse terms. Fair value is not, therefore, the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale. However, fair value reflects the credit quality of the instrument. [No IFRS equivalent, IPSAS 29 AG101]

AG132. This Standard uses the terms “bid price” and “asking price” (sometimes referred to as “current offer price”) in the context of quoted market prices, and the term “the bid-ask spread” to include only transaction costs. Other adjustments to arrive at fair value (e.g., for counterparty credit risk) are not included in the term “bid-ask spread.” [No IFRS equivalent, IPSAS 29 AG102]

Active Market: Quoted Price

AG133. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm’s length basis. Fair value is defined in terms of a price agreed by a willing buyer and a willing seller in an arm’s length transaction. The objective of determining fair value for a financial instrument that is traded in an active market is to arrive at the price at which a transaction would occur at the end of the reporting period in that instrument (i.e., without modifying or repackaging the instrument) in the most advantageous active market to which the entity has immediate access. However, the entity adjusts the price in the more advantageous market to reflect any differences in counterparty credit risk between instruments traded in that market and the one being valued. The existence of published price quotations in an active market is the best evidence of fair value and when they exist they are used to measure the financial asset or financial liability. [No IFRS equivalent, IPSAS 29 AG103]

AG134. The appropriate quoted market price for an asset held or liability to be issued is usually the current bid price and, for an asset to be acquired or liability held, the asking price. When an entity has assets and liabilities with offsetting market risks, it may use mid-market prices as a basis for establishing fair values for the offsetting risk positions and apply the bid or asking price to the net open position as appropriate. When current bid and asking prices are unavailable, the price of the most recent transaction provides evidence of the current fair value as long as there has not been a significant change in economic circumstances since the time of the transaction. If conditions have changed since the time of the transaction (e.g., a change in the risk-free interest rate following the most recent price quote for a government bond), the fair value reflects the change in conditions by reference to current prices or rates for similar financial instruments, as appropriate. Similarly, if the entity can demonstrate that the last transaction price is not fair value (e.g., because it reflected the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale), that price is adjusted. The fair value of a portfolio of financial instruments is the product of the number of units of the instrument and its quoted market price. If a published price quotation in an active market does not exist for a financial instrument in its entirety, but active markets exist for its component parts, fair value is determined on the basis of the relevant market prices for the component parts. [No IFRS equivalent, IPSAS 29 AG104]

AG135. If a rate (rather than a price) is quoted in an active market, the entity uses that market-quoted rate as an input into a valuation technique to determine fair value. If the market-quoted rate does not include credit risk or other factors that market participants would include in valuing the instrument, the entity adjusts for those factors. [No IFRS equivalent, IPSAS 29 AG105]

No Active Market: Valuation Technique

AG136. If the market for a financial instrument is not active, an entity establishes fair value by using a valuation technique. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, if available, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the entity uses that technique. [No IFRS equivalent, IPSAS 29 AG106]

AG137. The objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal operating considerations. Fair value is estimated on the basis of the results of a valuation technique that makes maximum use of market inputs, and relies as little as possible on entity-specific inputs. A valuation technique would be expected to arrive at a realistic estimate of the fair value if (a) it reasonably reflects how the market could be expected to price the instrument and (b) the inputs to the valuation technique reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument. [No IFRS equivalent, IPSAS 29 AG107]

AG138. Therefore, a valuation technique (a) incorporates all factors that market participants would consider in setting a price and (b) is consistent with accepted economic methodologies for pricing financial instruments. Periodically, an entity calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on any available observable market data. An entity obtains market data consistently in the same market where the instrument was originated or purchased. The best evidence of the fair value of a financial instrument at initial recognition, in an exchange transaction, is the transaction price (i.e., the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. [No IFRS equivalent, IPSAS 29 AG108]

AG139. The subsequent measurement of the financial asset or financial liability and the subsequent recognition of gains and losses shall be consistent with the requirements of this Standard. The application of paragraph AG138 may result in no gain or loss being recognized on the initial recognition of a financial asset or financial liability. In such a case, IPSAS 29 requires that a gain or loss shall be recognized after initial recognition only to the extent that it arises from a change in a factor (including time) that market participants would consider in setting a price. [No IFRS equivalent, IPSAS 29 AG109]

AG140. The initial acquisition or origination of a financial asset or incurrence of a financial liability is a market transaction that provides a foundation for estimating the fair value of the financial instrument. In particular, if the financial instrument is a debt instrument (such as a loan), its fair value can be determined by reference to the market conditions that existed at its acquisition or origination date and current market conditions or interest rates currently charged by the entity

or by others for similar debt instruments (i.e., similar remaining maturity, cash flow pattern, currency, credit risk, collateral and interest basis). Alternatively, provided there is no change in the credit risk of the debtor and applicable credit spreads after the origination of the debt instrument, an estimate of the current market interest rate may be derived by using a benchmark interest rate reflecting a better credit quality than the underlying debt instrument, holding the credit spread constant, and adjusting for the change in the benchmark interest rate from the origination date. If conditions have changed since the most recent market transaction, the corresponding change in the fair value of the financial instrument being valued is determined by reference to current prices or rates for similar financial instruments, adjusted as appropriate, for any differences from the instrument being valued. [No IFRS equivalent, IPSAS 29 AG110]

AG141. The same information may not be available at each measurement date. For example, at the date that an entity makes a loan or acquires a debt instrument that is not actively traded, the entity has a transaction price that is also a market price. However, no new transaction information may be available at the next measurement date and, although the entity can determine the general level of market interest rates, it may not know what level of credit or other risk market participants would consider in pricing the instrument on that date. An entity may not have information from recent transactions to determine the appropriate credit spread over the basic interest rate to use in determining a discount rate for a present value computation. It would be reasonable to assume, in the absence of evidence to the contrary, that no changes have taken place in the spread that existed at the date the loan was made. However, the entity would be expected to make reasonable efforts to determine whether there is evidence that there has been a change in such factors. When evidence of a change exists, the entity would consider the effects of the change in determining the fair value of the financial instrument. [No IFRS equivalent, IPSAS 29 AG111]

AG142. In applying discounted cash flow analysis, an entity uses one or more discount rates equal to the prevailing rates of return for financial instruments having substantially the same terms and characteristics, including the credit quality of the instrument, the remaining term over which the contractual interest rate is fixed, the remaining term to repayment of the principal and the currency in which payments are to be made. Short-term receivables and payables with no stated interest rate may be measured at the original invoice amount if the effect of discounting is immaterial. [No IFRS equivalent, IPSAS 29 AG112]

Inputs to Valuation Techniques

AG143. An appropriate technique for estimating the fair value of a particular financial instrument would incorporate observable market data about the market conditions and other factors that are likely to affect the instrument's fair value. The fair value of a financial instrument will be based on one or more of the following factors (and perhaps others). [No IFRS equivalent, IPSAS 29 AG115]

- (a) The time value of money (i.e., interest at the basic or risk-free rate). Basic interest rates can usually be derived from observable government bond prices and are often quoted in financial publications. These rates typically vary with the expected dates of the projected cash flows along a yield curve of interest rates for different time horizons. For practical reasons, an entity may use a well-accepted and readily observable general market rate, such as a swap rate, as the benchmark rate. (If the rate used is not the risk-free interest rate, the credit risk adjustment appropriate to the particular financial instrument is determined on the basis of its credit risk in relation to the credit risk in this benchmark rate). In some countries, the central government's bonds may carry a significant credit risk and may not provide a stable benchmark basic interest rate for instruments denominated in that currency. Some entities in these countries may have a

- better credit standing and a lower borrowing rate than the central government. In such a case, basic interest rates may be more appropriately determined by reference to interest rates for the highest rated corporate bonds issued in the currency of that jurisdiction.
- (b) Credit risk. The effect on fair value of credit risk (i.e., the premium over the basic interest rate for credit risk) may be derived from observable market prices for traded instruments of different credit quality or from observable interest rates charged by lenders for loans of various credit ratings.
 - (c) Foreign currency exchange prices. Active currency exchange markets exist for most major currencies, and prices are quoted daily in financial publications.
 - (d) Commodity prices. There are observable market prices for many commodities.
 - (e) Equity prices. Prices (and indexes of prices) of traded equity instruments are readily observable in some markets. Present value based techniques may be used to estimate the current market price of equity instruments for which there are no observable prices.
 - (f) Volatility (i.e., magnitude of future changes in price of the financial instrument or other item). Measures of the volatility of actively traded items can normally be reasonably estimated on the basis of historical market data or by using volatilities implied in current market prices.
 - (g) Prepayment risk and surrender risk. Expected prepayment patterns for financial assets and expected surrender patterns for financial liabilities can be estimated on the basis of historical data. (The fair value of a financial liability that can be surrendered by the counterparty cannot be less than the present value of the surrender amount – see paragraph 65).
 - (a) Servicing costs for a financial asset or a financial liability. Costs of servicing can be estimated using comparisons with current fees charged by other market participants. If the costs of servicing a financial asset or financial liability are significant and other market participants would face comparable costs, the issuer would consider them in determining the fair value of that financial asset or financial liability. It is likely that the fair value at inception of a contractual right to future fees equals the origination costs paid for them, unless future fees and related costs are out of line with market comparables.

~~Amortised~~Amortized cost measurement

Effective interest method

~~AG114.~~AG144. In applying the effective interest method, an entity identifies fees that are an integral part of the effective interest rate of a financial instrument. The description of fees for financial services may not be indicative of the nature and substance of the services provided. Fees that are an integral part of the effective interest rate of a financial instrument are treated as an adjustment to the effective interest rate, unless the financial instrument is measured at fair value, with the change in fair value being ~~recognised~~recognized in ~~profit or loss~~surplus or deficit. In those cases, the fees are ~~recognised~~recognized as revenue or expense when the instrument is initially ~~recognised~~recognized. [IFRS 9 Par. B5.4.1, no IPSAS 29 equivalent paragraph]

~~AG115.~~AG145. Fees that are an integral part of the effective interest rate of a financial instrument include:

- (a) ~~e~~Origination fees received by the entity relating to the creation or acquisition of a financial asset. Such fees may include compensation for activities such as evaluating the borrower's financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the

transaction. These fees are an integral part of generating an involvement with the resulting financial instrument.

- (b) ~~e~~C Commitment fees received by the entity to originate a loan when the loan commitment is not measured in accordance with paragraph 44(a)~~4.2.1(a)~~ and it is probable that the entity will enter into a specific lending arrangement. These fees are regarded as compensation for an ongoing involvement with the acquisition of a financial instrument. If the commitment expires without the entity making the loan, the fee is ~~recognised~~recognized as revenue on expiry.
- (c) ~~e~~O Origination fees paid on issuing financial liabilities measured at ~~amortised~~amortized cost. These fees are an integral part of generating an involvement with a financial liability. An entity distinguishes fees and costs that are an integral part of the effective interest rate for the financial liability from origination fees and transaction costs relating to the right to provide services, such as investment management services. [IFRS 9 Par. B5.4.2, no IPSAS 29 equivalent paragraph]

~~AG116-AG146.~~ Fees that are not an integral part of the effective interest rate of a financial instrument and are accounted for in accordance with ~~IFRS 15~~IPSAS 9 include:

- (a) ~~f~~E Fees charged for servicing a loan;
- (b) ~~e~~C Commitment fees to originate a loan when the loan commitment is not measured in accordance with paragraph 44(a)~~4.2.1(a)~~ and it is unlikely that a specific lending arrangement will be entered into; and
- (c) ~~l~~ Loan syndication fees received by an entity that arranges a loan and retains no part of the loan package for itself (or retains a part at the same effective interest rate for comparable risk as other participants). [IFRS 9 Par. B5.4.3, no IPSAS 29 equivalent paragraph]

~~AG117-AG147.~~ When applying the effective interest method, an entity generally ~~amortises~~amortizes any fees, points paid or received, transaction costs and other premiums or discounts that are included in the calculation of the effective interest rate over the expected life of the financial instrument. However, a shorter period is used if this is the period to which the fees, points paid or received, transaction costs, premiums or discounts relate. This will be the case when the variable to which the fees, points paid or received, transaction costs, premiums or discounts relate is repriced to market rates before the expected maturity of the financial instrument. In such a case, the appropriate ~~amortisation~~amortization period is the period to the next such repricing date. For example, if a premium or discount on a floating-rate financial instrument reflects the interest that has accrued on that financial instrument since the interest was last paid, or changes in the market rates since the floating interest rate was reset to the market rates, it will be ~~amortised~~amortized to the next date when the floating interest is reset to market rates. This is because the premium or discount relates to the period to the next interest reset date because, at that date, the variable to which the premium or discount relates (ie interest rates) is reset to the market rates. If, however, the premium or discount results from a change in the credit spread over the floating rate specified in the financial instrument, or other variables that are not reset to the market rates, it is ~~amortised~~amortized over the expected life of the financial instrument. [IFRS 9 Par. B5.4.4, IPSAS 29 AG 18]

~~AG118-AG148.~~ For floating-rate financial assets and floating-rate financial liabilities, periodic re-estimation of cash flows to reflect the movements in the market rates of interest alters the effective interest rate. If a floating-rate financial asset or a floating-rate financial liability is ~~recognised~~recognized initially at an amount equal to the principal receivable or payable on maturity, re-estimating the future interest payments normally has no significant effect on the carrying amount of the asset or the liability. [IFRS 9 Par. B5.4.5, IPSAS 29 AG 19]

~~AG119-AG149.~~ If an entity revises its estimates of payments or receipts (excluding modifications in accordance with paragraph 68~~5.4.3~~ and changes in estimates of expected credit losses), it shall adjust the gross carrying amount of the financial asset or ~~amortised~~amortized cost of a financial liability (or group of financial instruments) to reflect actual and revised estimated contractual cash flows. The entity recalculates the gross carrying amount of the financial asset or ~~amortised~~amortized cost of the financial liability as the present value of the estimated future contractual cash flows that are discounted at the financial instrument'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 ~~XX6.5.10~~. The adjustment is ~~recognised~~recognized in ~~profit or loss~~surplus or deficit as ~~income~~revenue or expense. [IFRS 9 Par. B5.4.6, IPSAS 29 AG 20]

~~AG120-AG150.~~ In some cases a financial asset is considered credit-impaired at initial recognition because the credit risk is very high, and in the case of a purchase it is acquired at a deep discount. An entity is required to include the initial expected credit losses in the estimated cash flows when calculating the credit-adjusted effective interest rate for financial assets that are considered to be purchased or originated credit-impaired at initial recognition. However, this does not mean that a credit-adjusted effective interest rate should be applied solely because the financial asset has high credit risk at initial recognition. [IFRS 9 Par. B5.4.7, No equivalent paragraph under IPSAS 29]

Transaction costs

~~AG121-AG151.~~ Transaction costs include fees and commission paid to agents (including employees acting as selling agents), advisers, brokers and dealers, levies by regulatory agencies and security exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs. [IFRS 9 Par. B5.4.8, IPSAS 29 AG26]

Write-off

~~AG122-AG152.~~ Write-offs can relate to a financial asset in its entirety or to a portion of it. For example, an entity plans to enforce the collateral on a financial asset and expects to recover no more than 30 per cent of the financial asset from the collateral. If the entity has no reasonable prospects of recovering any further cash flows from the financial asset, it should write off the remaining 70 per cent of the financial asset. [IFRS 9 Par. B5.4.9, no IPSAS 29 equivalent]

~~[Note 52: IFRS 9 adds explicit guidance and application guidance to write off a financial asset or a portion of a financial asset when it has no reasonable prospects of recovering the value of it. This is consistent with the forward looking approach of the ECL model. No public sector reason identified to depart from this guidance.]~~

Impairment

Collective and individual assessment basis

~~AG123-AG153.~~ In order to meet the objective of ~~recognising~~recognizing lifetime expected credit losses for significant increases in credit risk since initial recognition, it may be necessary to perform the assessment of significant increases in credit risk on a collective basis by considering information that is indicative of significant increases in credit risk on, for example, a group or sub-group of financial instruments. This is to ensure that an entity meets the objective of ~~recognising~~recognizing lifetime expected credit losses when there are significant increases in

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credit risk, even if evidence of such significant increases in credit risk at the individual instrument level is not yet available. [IFRS 9 Par. B5.5.1]

~~AG124~~~~AG154~~. Lifetime expected credit losses are generally expected to be ~~recognised~~~~recognized~~ before a financial instrument becomes past due. Typically, credit risk increases significantly before a financial instrument becomes past due or other lagging borrower-specific factors (for example, a modification or restructuring) are observed. Consequently when reasonable and supportable information that is more forward-looking than past due information is available without undue cost or effort, it must be used to assess changes in credit risk. [IFRS 9 Par. B5.5.2]

~~AG125~~~~AG155~~. However, depending on the nature of the financial instruments and the credit risk information available for particular groups of financial instruments, an entity may not be able to identify significant changes in credit risk for individual financial instruments before the financial instrument becomes past due. This may be the case for financial instruments such as retail loans for which there is little or no updated credit risk information that is routinely obtained and monitored on an individual instrument until a ~~customer~~~~borrower~~ breaches the contractual terms. If changes in the credit risk for individual financial instruments are not captured before they become past due, a loss allowance based only on credit information at an individual financial instrument level would not faithfully represent the changes in credit risk since initial recognition. [IFRS 9 Par. B5.5.3]

~~AG126~~~~AG156~~. In some circumstances an entity does not have reasonable and supportable information that is available without undue cost or effort to measure lifetime expected credit losses on an individual instrument basis. In that case, lifetime expected credit losses shall be ~~recognised~~~~recognized~~ on a collective basis that considers comprehensive credit risk information. This comprehensive credit risk information must incorporate not only past due information but also all relevant credit information, including forward-looking macroeconomic information, in order to approximate the result of ~~recognising~~~~recognizing~~ lifetime expected credit losses when there has been a significant increase in credit risk since initial recognition on an individual instrument level. [IFRS 9 Par. B5.5.4]

~~AG127~~~~AG157~~. For the purpose of determining significant increases in credit risk and ~~recognising~~~~recognizing~~ a loss allowance on a collective basis, an entity can group financial instruments on the basis of shared credit risk characteristics with the objective of facilitating an analysis that is designed to enable significant increases in credit risk to be identified on a timely basis. The entity should not obscure this information by grouping financial instruments with different risk characteristics. Examples of shared credit risk characteristics may include, but are not limited to, the:

- (a) ~~i~~~~n~~strument type;
- (b) ~~e~~~~C~~redit risk ratings;
- (c) ~~e~~~~C~~ollateral type;
- (d) ~~d~~~~D~~ate of initial recognition;
- (e) ~~r~~~~R~~emaining term to maturity;
- (f) ~~i~~~~I~~ndustry;
- (g) ~~g~~~~G~~eographical location of the borrower; and

- (h) ~~the~~ The value of collateral relative to the financial asset if it has an impact on the probability of a default occurring (for example, non-recourse loans in some jurisdictions or loan-to-value ratios). [IFRS 9 Par. B5.552]

~~AG128-AG158.~~ Paragraph ~~735-5-4~~ requires that lifetime expected credit losses are ~~recognised~~~~recognized~~ on all financial instruments for which there has been significant increases in credit risk since initial recognition. In order to meet this objective, if an entity is not able to group financial instruments for which the credit risk is considered to have increased significantly since initial recognition based on shared credit risk characteristics, the entity should ~~recognise~~~~recognize~~ lifetime expected credit losses on a portion of the financial assets for which credit risk is deemed to have increased significantly. The aggregation of financial instruments to assess whether there are changes in credit risk on a collective basis may change over time as new information becomes available on groups of, or individual, financial instruments. [IFRS 9 Par. B5.5.6]

Timing of ~~recognising~~~~recognizing~~ lifetime expected credit losses

~~AG129-AG159.~~ The assessment of whether lifetime expected credit losses should be ~~recognised~~~~recognized~~ is based on significant increases in the likelihood or risk of a default occurring since initial recognition (irrespective of whether a financial instrument has been repriced to reflect an increase in credit risk) instead of on evidence of a financial asset being credit-impaired at the reporting date or an actual default occurring. Generally, there will be a significant increase in credit risk before a financial asset becomes credit-impaired or an actual default occurs. [IFRS 9 Par. B5.5.7]

~~AG130-AG160.~~ For loan commitments, an entity considers changes in the risk of a default occurring on the loan to which a loan commitment relates. For financial guarantee contracts, an entity considers the changes in the risk that the specified debtor will default on the contract. [IFRS 9 Par. B5.5.8]

~~AG131-AG161.~~ The significance of a change in the credit risk since initial recognition depends on the risk of a default occurring as at initial recognition. Thus, a given change, in absolute terms, in the risk of a default occurring will be more significant for a financial instrument with a lower initial risk of a default occurring compared to a financial instrument with a higher initial risk of a default occurring. [IFRS 9 Par. B5.5.9]

~~AG132-AG162.~~ The risk of a default occurring on financial instruments that have comparable credit risk is higher the longer the expected life of the instrument; for example, the risk of a default occurring on an AAA-rated bond with an expected life of 10 years is higher than that on an AAA-rated bond with an expected life of five years. [IFRS 9 Par. B5.5.10]

~~AG133-AG163.~~ Because of the relationship between the expected life and the risk of a default occurring, the change in credit risk cannot be assessed simply by comparing the change in the absolute risk of a default occurring over time. For example, if the risk of a default occurring for a financial instrument with an expected life of 10 years at initial recognition is identical to the risk of a default occurring on that financial instrument when its expected life in a subsequent period is only five years, that may indicate an increase in credit risk. This is because the risk of a default occurring over the expected life usually decreases as time passes if the credit risk is unchanged and the financial instrument is closer to maturity. However, for financial instruments that only have significant payment obligations close to the maturity of the financial instrument the risk of a default occurring may not necessarily decrease as time passes. In such a case, an entity should also consider other qualitative factors that would demonstrate whether credit risk has increased significantly since initial recognition. [IFRS 9 Par. B5.5.11]

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~~AG134-AG164.~~ An entity may apply various approaches when assessing whether the credit risk on a financial instrument has increased significantly since initial recognition or when measuring expected credit losses. An entity may apply different approaches for different financial instruments. An approach that does not include an explicit probability of default as an input per se, such as a credit loss rate approach, can be consistent with the requirements in this Standard, provided that an entity is able to separate the changes in the risk of a default occurring from changes in other drivers of expected credit losses, such as collateral, and considers the following when making the assessment:

- (a) ~~t~~The change in the risk of a default occurring since initial recognition;
- (b) ~~t~~The expected life of the financial instrument; and
- (c) ~~r~~Reasonable and supportable information that is available without undue cost or effort that may affect credit risk. [IFRS 9 Par. B5.5.12]

~~AG135-AG165.~~ The methods used to determine whether credit risk has increased significantly on a financial instrument since initial recognition should consider the characteristics of the financial instrument (or group of financial instruments) and the default patterns in the past for comparable financial instruments. Despite the requirement in paragraph 78~~5.5.9~~, for financial instruments for which default patterns are not concentrated at a specific point during the expected life of the financial instrument, changes in the risk of a default occurring over the next 12 months may be a reasonable approximation of the changes in the lifetime risk of a default occurring. In such cases, an entity may use changes in the risk of a default occurring over the next 12 months to determine whether credit risk has increased significantly since initial recognition, unless circumstances indicate that a lifetime assessment is necessary. [IFRS 9 Par. B5.5.13]

~~AG136-AG166.~~ ——— However, for some financial instruments, or in some circumstances, it may not be appropriate to use changes in the risk of a default occurring over the next 12 months to determine whether lifetime expected credit losses should be ~~recognised~~recognized. For example, the change in the risk of a default occurring in the next 12 months may not be a suitable basis for determining whether credit risk has increased on a financial instrument with a maturity of more than 12 months when:

- (a) ~~t~~The financial instrument only has significant payment obligations beyond the next 12 months;
- (b) ~~e~~Changes in relevant macroeconomic or other credit-related factors occur that are not adequately reflected in the risk of a default occurring in the next 12 months; or
- (c) ~~e~~Changes in credit-related factors only have an impact on the credit risk of the financial instrument (or have a more pronounced effect) beyond 12 months. [IFRS 9 Par. B5.5.14]

Determining whether credit risk has increased significantly since initial recognition

~~AG137-AG167.~~ When determining whether the recognition of lifetime expected credit losses is required, an entity shall consider reasonable and supportable information that is available without undue cost or effort and that may affect the credit risk on a financial instrument in accordance with paragraph 86(c)~~5.5.17(e)~~. An entity need not undertake an exhaustive search for information when determining whether credit risk has increased significantly since initial recognition. [IFRS 9 Par. B5.5.15]

~~AG138-AG168.~~ ——— Credit risk analysis is a multifactor and holistic analysis; whether a specific factor is relevant, and its weight compared to other factors, will depend on the type of product, characteristics of the financial instruments and the borrower as well as the geographical region. An entity shall consider reasonable and supportable information that is available without undue

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cost or effort and that is relevant for the particular financial instrument being assessed. However, some factors or indicators may not be identifiable on an individual financial instrument level. In such a case, the factors or indicators should be assessed for appropriate portfolios, groups of portfolios or portions of a portfolio of financial instruments to determine whether the requirement in paragraph 725.5.3 for the recognition of lifetime expected credit losses has been met. [IFRS 9 Par. B5.5.16]

~~AG139-AG169.~~ — The following non-exhaustive list of information may be relevant in assessing changes in credit risk:

- (a) ~~s~~Significant changes in internal price indicators of credit risk as a result of a change in credit risk since inception, including, but not limited to, the credit spread that would result if a particular financial instrument or similar financial instrument with the same terms and the same counterparty were newly originated or issued at the reporting date.
- (b) ~~e~~Other changes in the rates or terms of an existing financial instrument that would be significantly different if the instrument was newly originated or issued at the reporting date (such as more stringent covenants, increased amounts of collateral or guarantees, or higher ~~income~~revenue coverage) because of changes in the credit risk of the financial instrument since initial recognition.
- (c) ~~s~~Significant changes in external market indicators of credit risk for a particular financial instrument or similar financial instruments with the same expected life. Changes in market indicators of credit risk include, but are not limited to:
 - (i) ~~t~~The credit spread;
 - (ii) ~~t~~The credit default swap prices for the borrower;
 - (iii) ~~t~~The length of time or the extent to which the fair value of a financial asset has been less than its ~~amortised~~amortized cost; and
 - (iv) ~~e~~Other market information related to the borrower, such as changes in the price of a borrower's debt and equity instruments.
- (d) ~~a~~An actual or expected significant change in the financial instrument's external credit rating.
- (e) ~~a~~An actual or expected internal credit rating downgrade for the borrower or decrease in ~~behaviour~~behavioral scoring used to assess credit risk internally. Internal credit ratings and internal ~~behaviour~~behavioral scoring are more reliable when they are mapped to external ratings or supported by default studies.
- (f) ~~e~~Existing or forecast adverse changes in business, financial or economic conditions that are expected to cause a significant change in the borrower's ability to meet its debt obligations, such as an actual or expected increase in interest rates or an actual or expected significant increase in unemployment rates.
- (g) ~~a~~An actual or expected significant change in the operating results of the borrower. Examples include actual or expected declining revenues or margins, increasing operating risks, working capital deficiencies, decreasing asset quality, increased balance sheet leverage, liquidity, management problems or changes in the scope of ~~business—operation~~ or ~~organisational~~organizational structure (such as the discontinuance of a segment of the ~~business~~entity) that results in a significant change in the borrower's ability to meet its debt obligations.
- (h) ~~s~~Significant increases in credit risk on other financial instruments of the same borrower.

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- (i) ~~a~~An actual or expected significant adverse change in the regulatory, economic, or technological environment of the borrower that results in a significant change in the borrower's ability to meet its debt obligations, such as a decline in the demand for the borrower's sales product because of a shift in technology.
- (j) ~~s~~Significant changes in the value of the collateral supporting the obligation or in the quality of third-party guarantees or credit enhancements, which are expected to reduce the borrower's economic incentive to make scheduled contractual payments or to otherwise have an effect on the probability of a default occurring. For example, if the value of collateral declines because house prices decline, borrowers in some jurisdictions have a greater incentive to default on their mortgages.
- (k) ~~a~~A significant change in the quality of the guarantee provided by ~~a shareholder~~an entity's owners (or an individual's ~~parents~~guarantors) if the shareholder (or ~~guarantors~~parents) have an incentive and financial ability to prevent default by capital or cash infusion.
- (l) ~~s~~Significant changes, such as reductions in financial support from a ~~parent~~controlling entity or other affiliate or an actual or expected significant change in the quality of credit enhancement, that are expected to reduce the borrower's economic incentive to make scheduled contractual payments. Credit quality enhancements or support include the consideration of the financial condition of the guarantor and/or, for interests issued in ~~securitisation~~securitizations, whether subordinated interests are expected to be capable of absorbing expected credit losses (for example, on the loans underlying the security).
- (m) ~~e~~Expected changes in the loan documentation including an expected breach of contract that may lead to covenant waivers or amendments, interest payment holidays, interest rate step-ups, requiring additional collateral or guarantees, or other changes to the contractual framework of the instrument.
- (n) ~~s~~Significant changes in the expected performance and ~~behaviour~~behavior of the borrower, including changes in the payment status of borrowers in the ~~group~~economic entity (for example, an increase in the expected number or extent of delayed contractual payments or significant increases in the expected number of credit card borrowers who are expected to approach or exceed their credit limit or who are expected to be paying the minimum monthly amount).
- (o) ~~e~~Changes in the entity's credit management approach in relation to the financial instrument; i.e., based on emerging indicators of changes in the credit risk of the financial instrument, the entity's credit risk management practice is expected to become more active or to be focused on managing the instrument, including the instrument becoming more closely monitored or controlled, or the entity specifically intervening with the borrower.
- (p) ~~p~~Past due information, including the rebuttable presumption as set out in paragraph 80~~5.5.14~~.
[IFRS 9 Par. B5.5.17]

~~AG140-AG170~~. In some cases, the qualitative and non-statistical quantitative information available may be sufficient to determine that a financial instrument has met the criterion for the recognition of a loss allowance at an amount equal to lifetime expected credit losses. That is, the information does not need to flow through a statistical model or credit ratings process in order to determine whether there has been a significant increase in the credit risk of the financial instrument. In other cases, an entity may need to consider other information, including information from its statistical models or credit ratings processes. Alternatively, the entity may base the assessment on both types of information, i.e., qualitative factors that are not captured through the internal ratings process and a specific internal rating category at the reporting date, taking into

consideration the credit risk characteristics at initial recognition, if both types of information are relevant. [IFRS 9 Par. B5.5.18]

More than 30 days past due rebuttable presumption

~~AG141-AG171.~~ The rebuttable presumption in paragraph 805.5.11 is not an absolute indicator that lifetime expected credit losses should be ~~recognised~~recognized, but is presumed to be the latest point at which lifetime expected credit losses should be ~~recognised~~recognized even when using forward-looking information (including macroeconomic factors on a portfolio level). [IFRS 9 Par. B5.5.19]

~~AG142-AG172.~~ An entity can rebut this presumption. However, it can do so only when it has reasonable and supportable information available that demonstrates that even if contractual payments become more than 30 days past due, this does not represent a significant increase in the credit risk of a financial instrument. For example when non-payment was an administrative oversight, instead of resulting from financial difficulty of the borrower, or the entity has access to historical evidence that demonstrates that there is no correlation between significant increases in the risk of a default occurring and financial assets on which payments are more than 30 days past due, but that evidence does identify such a correlation when payments are more than 60 days past due. [IFRS 9 Par. B5.5.20]

~~AG143-AG173.~~ An entity cannot align the timing of significant increases in credit risk and the recognition of lifetime expected credit losses to when a financial asset is regarded as credit-impaired or an entity's internal definition of default. [IFRS 9 Par. B5.5.21]

Financial instruments that have low credit risk at the reporting date

~~AG144-AG174.~~ The credit risk on a financial instrument is considered low for the purposes of paragraph 795.5.10, if the financial instrument has a low risk of default, the borrower has a strong capacity to meet its contractual cash flow obligations in the near term and adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil its contractual cash flow obligations. Financial instruments are not considered to have low credit risk when they are regarded as having a low risk of loss simply because of the value of collateral and the financial instrument without that collateral would not be considered low credit risk. Financial instruments are also not considered to have low credit risk simply because they have a lower risk of default than the entity's other financial instruments or relative to the credit risk of the jurisdiction within which an entity operates. [IFRS B5.5.22]

~~AG145-AG175.~~ To determine whether a financial instrument has low credit risk, an entity may use its internal credit risk ratings or other methodologies that are consistent with a globally understood definition of low credit risk and that consider the risks and the type of financial instruments that are being assessed. An external rating of 'investment grade' is an example of a financial instrument that may be considered as having low credit risk. However, financial instruments are not required to be externally rated to be considered to have low credit risk. They should, however, be considered to have low credit risk from a market participant perspective taking into account all of the terms and conditions of the financial instrument. [IFRS 9 Par. B5.5.23]

~~AG146-AG176.~~ Lifetime expected credit losses are not ~~recognised~~recognized on a financial instrument simply because it was considered to have low credit risk in the previous reporting period and is not considered to have low credit risk at the reporting date. In such a case, an entity shall determine whether there has been a significant increase in credit risk since initial recognition and thus whether lifetime expected credit losses are required to be ~~recognised~~recognized in accordance with paragraph 725.5.3. [IFRS 9 Par. B5.5.24]

Modifications

~~AG147-AG177.~~ In some circumstances, the renegotiation or modification of the contractual cash flows of a financial asset can lead to the derecognition of the existing financial asset in accordance with this Standard. When the modification of a financial asset results in the derecognition of the existing financial asset and the subsequent recognition of the modified financial asset, the modified asset is considered a 'new' financial asset for the purposes of this Standard. [IFRS 9 Par. B5.5.25]

~~AG148-AG178.~~ Accordingly the date of the modification shall be treated as the date of initial recognition of that financial asset when applying the impairment requirements to the modified financial asset. This typically means measuring the loss allowance at an amount equal to 12-month expected credit losses until the requirements for the recognition of lifetime expected credit losses in paragraph 72~~5.5.3~~ are met. However, in some unusual circumstances following a modification that results in derecognition of the original financial asset, there may be evidence that the modified financial asset is credit-impaired at initial recognition, and thus, the financial asset should be ~~recognised~~recognized as an originated credit-impaired financial asset. This might occur, for example, in a situation in which there was a substantial modification of a distressed asset that resulted in the derecognition of the original financial asset. In such a case, it may be possible for the modification to result in a new financial asset which is credit-impaired at initial recognition. [IFRS 9 Par. B5.5.26]

~~AG149-AG179.~~ If the contractual cash flows on a financial asset have been renegotiated or otherwise modified, but the financial asset is not ~~derecognised~~derecognized, that financial asset is not automatically considered to have lower credit risk. An entity shall assess whether there has been a significant increase in credit risk since initial recognition on the basis of all reasonable and supportable information that is available without undue cost or effort. This includes historical and forward-looking information and an assessment of the credit risk over the expected life of the financial asset, which includes information about the circumstances that led to the modification. Evidence that the criteria for the recognition of lifetime expected credit losses are no longer met may include a history of up-to-date and timely payment performance against the modified contractual terms. Typically a ~~customer-borrower~~ would need to demonstrate consistently good payment ~~behaviour~~behavior over a period of time before the credit risk is considered to have decreased. For example, a history of missed or incomplete payments would not typically be erased by simply making one payment on time following a modification of the contractual terms. [IFRS 9 Par. B5.5.27]

Measurement of expected credit losses

Expected credit losses

~~AG150-AG180.~~ Expected credit losses are a probability-weighted estimate of credit losses (ie the present value of all cash shortfalls) over the expected life of the financial instrument. A cash shortfall is the difference between the cash flows that are due to an entity in accordance with the contract and the cash flows that the entity expects to receive. Because expected credit losses consider the amount and timing of payments, a credit loss arises even if the entity expects to be paid in full but later than when contractually due. [IFRS 9 Par. B5.5.28]

~~AG151-AG181.~~ For financial assets, a credit loss is the present value of the difference between:

- (a) ~~†~~The contractual cash flows that are due to an entity under the contract; and
- (b) ~~†~~The cash flows that the entity expects to receive. [IFRS 9 Par. B5.5.29]

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~~AG152-AG182.~~ For undrawn loan commitments, a credit loss is the present value of the difference between:

- (a) ~~t~~The contractual cash flows that are due to the entity if the holder of the loan commitment draws down the loan; and
- (b) ~~t~~The cash flows that the entity expects to receive if the loan is drawn down. [IFRS 9 Par. B5.5.30]

~~AG153-AG183.~~ An entity's estimate of expected credit losses on loan commitments shall be consistent with its expectations of drawdowns on that loan commitment, i.e. it shall consider the expected portion of the loan commitment that will be drawn down within 12 months of the reporting date when estimating 12-month expected credit losses, and the expected portion of the loan commitment that will be drawn down over the expected life of the loan commitment when estimating lifetime expected credit losses. [IFRS 9 Par. B5.5.31]

~~AG154-AG184.~~ For a financial guarantee contract, the entity is required to make payments only in the event of a default by the debtor in accordance with the terms of the instrument that is guaranteed. Accordingly, cash shortfalls are the expected payments to reimburse the holder for a credit loss that it incurs less any amounts that the entity expects to receive from the holder, the debtor or any other party. If the asset is fully guaranteed, the estimation of cash shortfalls for a financial guarantee contract would be consistent with the estimations of cash shortfalls for the asset subject to the guarantee. [IFRS 9 Par. B5.5.32]

~~AG155-AG185.~~ For a financial asset that is credit-impaired at the reporting date, but that is not a purchased or originated credit-impaired financial asset, an entity shall measure the expected credit losses as the difference between the asset's gross carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. Any adjustment is ~~recognised~~recognized in ~~profit or loss~~surplus or deficit as an impairment gain or loss. [IFRS 9 Par. B5.5.33]

~~AG156-AG186.~~ When measuring a loss allowance for a lease receivable, the cash flows used for determining the expected credit losses should be consistent with the cash flows used in measuring the lease receivable in accordance with ~~IFRS 16~~IPSAS 13 Leases. [IFRS 9 Par. B5.5.34]

~~AG157-AG187.~~ An entity may use practical expedients when measuring expected credit losses if they are consistent with the principles in paragraph 86~~5.5.17~~. An example of a practical expedient is the calculation of the expected credit losses on ~~trade~~-receivables using a provision matrix. The entity would use its historical credit loss experience (adjusted as appropriate in accordance with paragraphs AG203~~B5.5.51~~–AG204~~B5.5.52~~) for ~~trade~~-receivables to estimate the 12-month expected credit losses or the lifetime expected credit losses on the financial assets as relevant. A provision matrix might, for example, specify fixed provision rates depending on the number of days that a trade receivable is past due (for example, 1 per cent if not past due, 2 per cent if less than 30 days past due, 3 per cent if more than 30 days but less than 90 days past due, 20 per cent if 90–180 days past due etc). Depending on the diversity of its customer base, the entity would use appropriate groupings if its historical credit loss experience shows significantly different loss patterns for different customer segments. Examples of criteria that might be used to group assets include geographical region, product type, customer rating, collateral or trade credit insurance and type of customer (such as ~~wholesale or retail~~other government entities or individuals). [IFRS 9 Par. B5.5.35]

Definition of default

~~AG158-AG188.~~ Paragraph 78~~5.5.9~~ requires that when determining whether the credit risk on a financial instrument has increased significantly, an entity shall consider the change in the risk of a default occurring since initial recognition. [IFRS 9 Par. B5.5.36]

~~AG159-AG189.~~ When defining default for the purposes of determining the risk of a default occurring, an entity shall apply a default definition that is consistent with the definition used for internal credit risk management purposes for the relevant financial instrument and consider qualitative indicators (for example, financial covenants) when appropriate. However, there is a rebuttable presumption that default does not occur later than when a financial asset is 90 days past due unless an entity has reasonable and supportable information to demonstrate that a more lagging default criterion is more appropriate. The definition of default used for these purposes shall be applied consistently to all financial instruments unless information becomes available that demonstrates that another default definition is more appropriate for a particular financial instrument. [IFRS 9 Par. B5.5.37]

Period over which to estimate expected credit losses

~~AG160-AG190.~~ In accordance with paragraph 88~~5.5.19~~, the maximum period over which expected credit losses shall be measured is the maximum contractual period over which the entity is exposed to credit risk. For loan commitments and financial guarantee contracts, this is the maximum contractual period over which an entity has a present contractual obligation to extend credit. [IFRS 9 Par. B5.5.38]

~~AG161-AG191.~~ However, in accordance with paragraph 89~~5.5.20~~, 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 example, revolving credit facilities, such as ~~credit cards and overdraft facilities~~ a line of credit provided by a government owned bank, can be contractually withdrawn by the lender with as little as one day's notice. However, in practice lenders continue to extend credit for a longer period and may only withdraw the facility after the credit risk of the borrower increases, which could be too late to prevent some or all of the expected credit losses. These financial instruments generally have the following characteristics as a result of the nature of the financial instrument, the way in which the financial instruments are managed, and the nature of the available information about significant increases in credit risk:

- (a) ~~†~~The financial instruments do not have a fixed term or repayment structure and usually have a short contractual cancellation period (for example, one day);
- (b) ~~†~~The contractual ability to cancel the contract is not enforced in the normal day-to-day management of the financial instrument and the contract may only be cancelled when the entity becomes aware of an increase in credit risk at the facility level; and
- (c) ~~†~~The financial instruments are managed on a collective basis. [IFRS 9 Par. B5.5.39]

~~AG162-AG192.~~ When determining the period over which the entity is expected to be exposed to credit risk, but for which expected credit losses would not be mitigated by the entity's normal credit risk management actions, an entity should consider factors such as historical information and experience about:

- (a) ~~†~~The period over which the entity was exposed to credit risk on similar financial instruments;

- (b) ~~†~~The length of time for related defaults to occur on similar financial instruments following a significant increase in credit risk; and
- (c) ~~†~~The credit risk management actions that an entity expects to take once the credit risk on the financial instrument has increased, such as the reduction or removal of undrawn limits. [IFRS 9 Par. B5.5.40]

Probability-weighted outcome

~~AG163-AG193.~~ The purpose of estimating expected credit losses is neither to estimate a worst-case scenario nor to estimate the best-case scenario. Instead, an estimate of expected credit losses shall always reflect the possibility that a credit loss occurs and the possibility that no credit loss occurs even if the most likely outcome is no credit loss. [IFRS 9 Par. B5.5.41]

~~AG164-AG194.~~ Paragraph 86(a)~~5.5.17(a)~~ requires the estimate of expected credit losses to reflect an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes. In practice, this may not need to be a complex analysis. In some cases, relatively simple modelling may be sufficient, without the need for a large number of detailed simulations of scenarios. For example, the average credit losses of a large group of financial instruments with shared risk characteristics may be a reasonable estimate of the probability-weighted amount. In other situations, the identification of scenarios that specify the amount and timing of the cash flows for particular outcomes and the estimated probability of those outcomes will probably be needed. In those situations, the expected credit losses shall reflect at least two outcomes in accordance with paragraph 87~~5.5.18~~. [IFRS 9 Par. B5.5.42]

~~AG165-AG195.~~ For lifetime expected credit losses, an entity shall estimate the risk of a default occurring on the financial instrument during its expected life. 12-month expected credit losses are a portion of the lifetime expected credit losses and represent the lifetime cash shortfalls that will result if a default occurs in the 12 months after the reporting date (or a shorter period if the expected life of a financial instrument is less than 12 months), weighted by the probability of that default occurring. Thus, 12-month expected credit losses are neither the lifetime expected credit losses that an entity will incur on financial instruments that it predicts will default in the next 12 months nor the cash shortfalls that are predicted over the next 12 months. [IFRS 9 Par. B5.5.43]

Time value of money

~~AG166-AG196.~~ Expected credit losses shall be discounted to the reporting date, not to the expected default or some other date, using the effective interest rate determined at initial recognition or an approximation thereof. If a financial instrument has a variable interest rate, expected credit losses shall be discounted using the current effective interest rate determined in accordance with paragraph AG148~~B5.4.5~~. [IFRS 9 Par. B5.5.44]

~~AG167-AG197.~~ For purchased or originated credit-impaired financial assets, expected credit losses shall be discounted using the credit-adjusted effective interest rate determined at initial recognition. [IFRS 9 Par. B5.5.45]

~~AG168-AG198.~~ Expected credit losses on lease receivables shall be discounted using the same discount rate used in the measurement of the lease receivable in accordance with ~~IFRS 46~~~~IPSAS 13~~. [IFRS 9 Par. B5.5.46]

~~AG169-AG199.~~ The expected credit losses on a loan commitment shall be discounted using the effective interest rate, or an approximation thereof, that will be applied when ~~recognising~~~~recognizing~~ the financial asset resulting from the loan commitment. This is because

for the purpose of applying the impairment requirements, a financial asset that is ~~recognised~~recognized following a draw down on a loan commitment shall be treated as a continuation of that commitment instead of as a new financial instrument. The expected credit losses on the financial asset shall therefore be measured considering the initial credit risk of the loan commitment from the date that the entity became a party to the irrevocable commitment. [IFRS 9 Par. B5.5.47]

~~AG170-AG200.~~ Expected credit losses on financial guarantee contracts or on loan commitments for which the effective interest rate cannot be determined shall be discounted by applying a discount rate that reflects the current market assessment of the time value of money and the risks that are specific to the cash flows but only if, and to the extent that, the risks are taken into account by adjusting the discount rate instead of adjusting the cash shortfalls being discounted. [IFRS 9 Par. B5.5.48]

Reasonable and supportable information

~~AG171-AG201.~~ For the purpose of this Standard, reasonable and supportable information is that which is reasonably available at the reporting date without undue cost or effort, including information about past events, current conditions and forecasts of future economic conditions. Information that is available for financial reporting purposes is considered to be available without undue cost or effort. [IFRS 9 Par. B5.5.49]

~~AG172-AG202.~~ An entity is not required to incorporate forecasts of future conditions over the entire expected life of a financial instrument. The degree of ~~judgement~~judgment that is required to estimate expected credit losses depends on the availability of detailed information. As the forecast horizon increases, the availability of detailed information decreases and the degree of ~~judgement~~judgment required to estimate expected credit losses increases. The estimate of expected credit losses does not require a detailed estimate for periods that are far in the future—for such periods, an entity may extrapolate projections from available, detailed information. [IFRS 9 Par. B5.5.50]

~~AG173-AG203.~~ An entity need not undertake an exhaustive search for information but shall consider all reasonable and supportable information that is available without undue cost or effort and that is relevant to the estimate of expected credit losses, including the effect of expected prepayments. The information used shall include factors that are specific to the borrower, general economic conditions and an assessment of both the current as well as the forecast direction of conditions at the reporting date. An entity may use various sources of data, that may be both internal (entity-specific) and external. Possible data sources include internal historical credit loss experience, internal ratings, credit loss experience of other entities and external ratings, reports and statistics. Entities that have no, or insufficient, sources of entity-specific data may use peer group experience for the comparable financial instrument (or groups of financial instruments). [IFRS 9 Par. B5.5.51]

~~AG174-AG204.~~ Historical information is an important anchor or base from which to measure expected credit losses. However, an entity shall adjust historical data, such as credit loss experience, on the basis of current observable data to reflect the effects of the current conditions and its forecasts of future conditions that did not affect the period on which the historical data is based, and to remove the effects of the conditions in the historical period that are not relevant to the future contractual cash flows. In some cases, the best reasonable and supportable information could be the unadjusted historical information, depending on the nature of the historical information and when it was calculated, compared to circumstances at the reporting date and the characteristics of the financial instrument being considered. Estimates of changes in

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expected credit losses should reflect, and be directionally consistent with, changes in related observable data from period to period (such as changes in unemployment rates, property prices, commodity prices, payment status or other factors that are indicative of credit losses on the financial instrument or in the group of financial instruments and in the magnitude of those changes). An entity shall regularly review the methodology and assumptions used for estimating expected credit losses to reduce any differences between estimates and actual credit loss experience. [IFRS 9 Par. B5.5.52]

~~AG175-AG205.~~ When using historical credit loss experience in estimating expected credit losses, it is important that information about historical credit loss rates is applied to groups that are defined in a manner that is consistent with the groups for which the historical credit loss rates were observed. Consequently, the method used shall enable each group of financial assets to be associated with information about past credit loss experience in groups of financial assets with similar risk characteristics and with relevant observable data that reflects current conditions. [IFRS 9 Par. B5.5.53]

~~AG176-AG206.~~ Expected credit losses reflect an entity's own expectations of credit losses. However, when considering all reasonable and supportable information that is available without undue cost or effort in estimating expected credit losses, an entity should also consider observable market information about the credit risk of the particular financial instrument or similar financial instruments. [IFRS 9 Par. B5.5.54]

Collateral

~~AG177-AG207.~~ For the purposes of measuring expected credit losses, the estimate of expected cash shortfalls shall reflect the cash flows expected from collateral and other credit enhancements that are part of the contractual terms and are not ~~recognised~~recognized separately by the entity. The estimate of expected cash shortfalls on a ~~collateralised~~collateralized financial instrument reflects the amount and timing of cash flows that are expected from foreclosure on the collateral less the costs of obtaining and selling the collateral, irrespective of whether foreclosure is probable (ie the estimate of expected cash flows considers the probability of a foreclosure and the cash flows that would result from it). Consequently, any cash flows that are expected from the ~~realisation~~realization of the collateral beyond the contractual maturity of the contract should be included in this analysis. Any collateral obtained as a result of foreclosure is not ~~recognised~~recognized as an asset that is separate from the ~~collateralised~~collateralized financial instrument unless it meets the relevant recognition criteria for an asset in this or other Standards. [IFRS 9 Par. B5.5.55]

Reclassification of financial assets

~~AG178-AG208.~~ If an entity reclassifies financial assets in accordance with paragraph 53~~4.4.1~~, paragraph 90~~5.6.1~~ requires that the reclassification is applied prospectively from the reclassification date. Both the ~~amortised~~amortized cost measurement category and the fair value through ~~other comprehensive income~~net assets/equity measurement category require that the effective interest rate is determined at initial recognition. Both of those measurement categories also require that the impairment requirements are applied in the same way. Consequently, when an entity reclassifies a financial asset between the ~~amortised~~amortized cost measurement category and the fair value through ~~other comprehensive income~~net assets/equity measurement category:

- (a) ~~t~~The recognition of interest revenue will not change and therefore the entity continues to use the same effective interest rate.

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- (b) ~~The~~ measurement of expected credit losses will not change because both measurement categories apply the same impairment approach. However if a financial asset is reclassified out of the fair value through ~~other comprehensive income~~~~net assets/equity~~ measurement category and into the ~~amortised~~~~amortized~~ cost measurement category, a loss allowance would be ~~recognised~~~~recognized~~ as an adjustment to the gross carrying amount of the financial asset from the reclassification date. If a financial asset is reclassified out of the ~~amortised~~~~amortized~~ cost measurement category and into the fair value through ~~other comprehensive income~~~~net assets/equity~~ measurement category, the loss allowance would be ~~derecognised~~~~derecognized~~ (and thus would no longer be ~~recognised~~~~recognized~~ as an adjustment to the gross carrying amount) but instead would be ~~recognised~~~~recognized~~ as an accumulated impairment amount (of an equal amount) in ~~other comprehensive income~~~~net assets/equity~~ and would be disclosed from the reclassification date. [IFRS 9 Par. B5.5.6.1]

~~AG179-AG209.~~ However, an entity is not required to separately ~~recognise~~~~recognize~~ interest revenue or impairment gains or losses for a financial asset measured at fair value through ~~profit or loss~~~~surplus or deficit~~. Consequently, when an entity reclassifies a financial asset out of the fair value through ~~profit or loss~~~~surplus or deficit~~ measurement category, the effective interest rate is determined on the basis of the fair value of the asset at the reclassification date. In addition, for the purposes of applying ~~paragraphs 70–89~~~~Section 5.5~~ to the financial asset from the reclassification date, the date of the reclassification is treated as the date of initial recognition. [IFRS 9 Par. B5.6.2]

Gains and losses

~~AG180-AG210.~~ Paragraph 102~~5.7.5~~ permits an entity to make an irrevocable election to present in ~~other comprehensive income~~~~net assets/equity~~ changes in the fair value of an investment in an equity instrument that is not held for trading. This election is made on an instrument-by-instrument (i.e., share-by-share) basis. Amounts presented in ~~other comprehensive income~~~~net assets/equity~~ shall not be subsequently transferred to ~~profit or loss~~~~surplus or deficit~~. However, the entity may transfer the cumulative gain or loss within ~~net assets/equity~~. Dividends ~~or similar distributions~~ on such investments are ~~recognised~~~~recognized~~ in ~~profit or loss~~~~surplus or deficit~~ in accordance with paragraph 103~~5.7.6~~ unless the dividend clearly represents a recovery of part of the cost of the investment. [IFRS 9 Par. B5.7.1, no IPSAS 29 equivalent]

~~AG181-AG211.~~ Unless paragraph 434~~4.1.5~~ applies, paragraph 404~~4.1.2A~~ requires that a financial asset is measured at fair value through ~~other comprehensive income~~~~net assets/equity~~ if the contractual terms of the financial asset give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding and the asset is held in a ~~business model~~~~management model~~ whose objective is achieved by both collecting contractual cash flows and selling financial assets. This measurement category ~~recognise~~~~recognizes~~ information in ~~profit or loss~~~~surplus or deficit~~ as if the financial asset is measured at ~~amortised~~~~amortized~~ cost, while the financial asset is measured in the statement of financial position at fair value. Gains or losses, other than those that are ~~recognised~~~~recognized~~ in ~~profit or loss~~~~surplus or deficit~~ in accordance with paragraphs 107~~5.7.10–108~~~~5.7.14~~, are ~~recognised~~~~recognized~~ in ~~other comprehensive income~~~~net assets/equity~~. When these financial assets are ~~derecognised~~~~derecognized~~, cumulative gains or losses previously ~~recognised~~~~recognized~~ in ~~other comprehensive income~~~~net assets/equity~~ are reclassified to ~~profit or loss~~~~surplus or deficit~~. This reflects the gain or loss that would have been ~~recognised~~~~recognized~~ in ~~profit or loss~~~~surplus or deficit~~ upon derecognition if the financial asset had been measured at ~~amortised~~~~amortized~~ cost. [IFRS 9 Par. B5.7.1A, no IPSAS 29 equivalent]

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~~AG182-AG212.~~ An entity applies ~~IAS 24~~IPSAS 4 to financial assets and financial liabilities that are monetary items in accordance with ~~IAS 24~~IPSAS 4 and denominated in a foreign currency. ~~IAS 24~~IPSAS 4 requires any foreign exchange gains and losses on monetary assets and monetary liabilities to be ~~recognised~~recognized in ~~profit or loss~~surplus or deficit. An exception is a monetary item that is designated as a hedging instrument in a cash flow hedge (see paragraph ~~XX6-5.11~~), a hedge of a net investment (see paragraph ~~XX 6-5.13~~) or a fair value hedge of an equity instrument for which an entity has elected to present changes in fair value in ~~other comprehensive income~~net assets/equity in accordance with paragraph 1025-7.5 (see paragraph ~~XX6-5.8~~). [IFRS 9 Par. B5.7.2, IPSAS 29 AG 211]

~~AG183-AG213.~~ For the purpose of ~~recognising~~recognizing foreign exchange gains and losses under ~~IAS 24~~IPSAS 4, a financial asset measured at fair value through ~~other comprehensive income~~net assets/equity in accordance with paragraph 404.1.2A is treated as a monetary item. Accordingly, such a financial asset is treated as an asset measured at ~~amortised~~amortized cost in the foreign currency. Exchange differences on the ~~amortised~~amortized cost are ~~recognised~~recognized in ~~profit or loss~~surplus or deficit and other changes in the carrying amount are ~~recognised~~recognized in accordance with paragraph 1075-7.10. [IFRS 9 Par. B5.7.2A, IPSAS 29 AG 211]

~~AG184-AG214.~~ Paragraph 1025-7.5 permits an entity to make an irrevocable election to present in ~~other comprehensive income~~net assets/equity subsequent changes in the fair value of particular investments in equity instruments. Such an investment is not a monetary item. Accordingly, the gain or loss that is presented in ~~other comprehensive income~~net assets/equity in accordance with paragraph 1025-7.5 includes any related foreign exchange component. [IFRS 9 Par. B5.7.3, IPSAS 29 AG 211]

~~AG185-AG215.~~ If there is a hedging relationship between a non-derivative monetary asset and a non-derivative monetary liability, changes in the foreign currency component of those financial instruments are presented in ~~profit or loss~~surplus or deficit. [IFRS 9 Par. B5.7.4, IPSAS 29 AG 211]

Liabilities designated as at fair value through ~~profit or loss~~surplus or deficit

~~AG186-AG216.~~ When an entity designates a financial liability as at fair value through ~~profit or loss~~surplus or deficit, it must determine whether presenting in ~~other comprehensive income~~net assets/equity the effects of changes in the liability's credit risk would create or enlarge an accounting mismatch in ~~profit or loss~~surplus or deficit. An accounting mismatch would be created or enlarged if presenting the effects of changes in the liability's credit risk in ~~other comprehensive income~~net assets/equity would result in a greater mismatch in ~~profit or loss~~surplus or deficit than if those amounts were presented in ~~profit or loss~~surplus or deficit. [IFRS 9 Par. B5.7.5]

~~AG187-AG217.~~ To make that determination, an entity must assess whether it expects that the effects of changes in the liability's credit risk will be offset in ~~profit or loss~~surplus or deficit by a change in the fair value of another financial instrument measured at fair value through ~~profit or loss~~surplus or deficit. Such an expectation must be based on an economic relationship between the characteristics of the liability and the characteristics of the other financial instrument. [IFRS 9 Par. B5.7.6]

~~AG188-AG218.~~ That determination is made at initial recognition and is not reassessed. For practical purposes the entity need not enter into all of the assets and liabilities giving rise to an accounting mismatch at exactly the same time. A reasonable delay is permitted provided that any remaining transactions are expected to occur. An entity must apply consistently its methodology for

determining whether presenting in ~~other comprehensive income~~ net assets/equity the effects of changes in the liability's credit risk would create or enlarge an accounting mismatch in ~~profit or loss~~ surplus or deficit. However, an entity may use different methodologies when there are different economic relationships between the characteristics of the liabilities designated as at fair value through ~~profit or loss~~ surplus or deficit and the characteristics of the other financial instruments. ~~IFRS 7~~ IPSAS 30 requires an entity to provide qualitative disclosures in the notes to the financial statements about its methodology for making that determination. [IFRS 9 Par. B5.7.7]

~~AG189~~ AG219. If such a mismatch would be created or enlarged, the entity is required to present all changes in fair value (including the effects of changes in the credit risk of the liability) in ~~profit or loss~~ surplus or deficit. If such a mismatch would not be created or enlarged, the entity is required to present the effects of changes in the liability's credit risk in ~~other comprehensive income~~ net assets/equity. [IFRS 9 Par. B5.7.8]

~~AG190~~ AG220. Amounts presented in ~~other comprehensive income~~ net assets/equity shall not be subsequently transferred to ~~profit or loss~~ surplus or deficit. However, the entity may transfer the cumulative gain or loss within equity. [IFRS 9 Par. B5.7.9]

~~AG191~~ AG221. The following example describes a situation in which an accounting mismatch would be created in ~~profit or loss~~ surplus or deficit if the effects of changes in the credit risk of the liability were presented in ~~other comprehensive income~~ net assets/equity. A mortgage bank provides loans to customers and funds those loans by selling bonds with matching characteristics (e.g., amount outstanding, repayment profile, term and currency) in the market. The contractual terms of the loan permit the mortgage customer to prepay its loan (i.e., satisfy its obligation to the bank) by buying the corresponding bond at fair value in the market and delivering that bond to the mortgage bank. As a result of that contractual prepayment right, if the credit quality of the bond worsens (and, thus, the fair value of the mortgage bank's liability decreases), the fair value of the mortgage bank's loan asset also decreases. The change in the fair value of the asset reflects the mortgage customer's contractual right to prepay the mortgage loan by buying the underlying bond at fair value (which, in this example, has decreased) and delivering the bond to the mortgage bank. Consequently, the effects of changes in the credit risk of the liability (the bond) will be offset in ~~profit or loss~~ surplus or deficit by a corresponding change in the fair value of a financial asset (the loan). If the effects of changes in the liability's credit risk were presented in ~~other comprehensive income~~ net assets/equity there would be an accounting mismatch in ~~profit or loss~~ surplus or deficit. Consequently, the mortgage bank is required to present all changes in fair value of the liability (including the effects of changes in the liability's credit risk) in ~~profit or loss~~ surplus or deficit. [IFRS 9 Par. B5.7.10]

~~AG192~~ AG222. In the example in paragraph AG221 ~~B5.7.10~~, there is a contractual linkage between the effects of changes in the credit risk of the liability and changes in the fair value of the financial asset (i.e., as a result of the mortgage customer's contractual right to prepay the loan by buying the bond at fair value and delivering the bond to the mortgage bank). However, an accounting mismatch may also occur in the absence of a contractual linkage. [IFRS 9 Par. B5.7.11]

~~AG193~~ AG223. For the purposes of applying the requirements in paragraphs 104 ~~5.7.7~~ and 105 ~~5.7.8~~, an accounting mismatch is not caused solely by the measurement method that an entity uses to determine the effects of changes in a liability's credit risk. An accounting mismatch in ~~profit or loss~~ surplus or deficit would arise only when the effects of changes in the liability's credit risk (as defined in ~~IFRS 7~~ IPSAS 30) are expected to be offset by changes in the fair value of another financial instrument. A mismatch that arises solely as a result of the measurement method (ie because an entity does not isolate changes in a liability's credit risk from some other changes

in its fair value) does not affect the determination required by paragraphs 104~~5.7.7~~ and 105~~5.7.8~~. For example, an entity may not isolate changes in a liability's credit risk from changes in liquidity risk. If the entity presents the combined effect of both factors in ~~other comprehensive income~~~~net assets/equity~~, a mismatch may occur because changes in liquidity risk may be included in the fair value measurement of the entity's financial assets and the entire fair value change of those assets is presented in ~~profit or loss~~~~surplus or deficit~~. However, such a mismatch is caused by measurement imprecision, not the offsetting relationship described in paragraph AG217~~B5.7.6~~ and, therefore, does not affect the determination required by paragraphs 104~~5.7.7~~ and 105~~5.7.8~~. [IFRS B5.7.12]

The meaning of 'credit risk' (paragraphs 104~~5.7.7~~ and 105~~5.7.8~~)

~~AG194-AG224.~~ ~~IFRS 7~~~~IPSAS 30~~ defines credit risk as 'the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation'. The requirement in paragraph 104(a)~~5.7.7(a)~~ relates to the risk that the issuer will fail to perform on that particular liability. It does not necessarily relate to the creditworthiness of the issuer. For example, if an entity issues a ~~collateralised~~~~collateralized~~ liability and a non-~~collateralised~~~~collateralized~~ liability that are otherwise identical, the credit risk of those two liabilities will be different, even though they are issued by the same entity. The credit risk on the ~~collateralised~~~~collateralized~~ liability will be less than the credit risk of the non-~~collateralised~~~~collateralized~~ liability. The credit risk for a ~~collateralised~~~~collateralized~~ liability may be close to zero. [IFRS 9 Par. B5.7.13]

~~AG195-AG225.~~ For the purposes of applying the requirement in paragraph 104(a)~~5.7.7(a)~~, credit risk is different from asset-specific performance risk. Asset-specific performance risk is not related to the risk that an entity will fail to discharge a particular obligation but instead it is related to the risk that a single asset or a group of assets will perform poorly (or not at all). [IFRS 9 Par. B5.7.14]

~~AG196-AG226.~~ The following are examples of asset-specific performance risk:

- (a) ~~aA~~ liability with a unit-linking feature whereby the amount due to investors is contractually determined on the basis of the performance of specified assets. The effect of that unit-linking feature on the fair value of the liability is asset-specific performance risk, not credit risk.
- (b) ~~aA~~ liability issued by a structured entity with the following characteristics. The entity is legally isolated so the assets in the entity are ring-fenced solely for the benefit of its investors, even in the event of bankruptcy. The entity enters into no other transactions and the assets in the entity cannot be hypothecated. Amounts are due to the entity's investors only if the ring-fenced assets generate cash flows. Thus, changes in the fair value of the liability primarily reflect changes in the fair value of the assets. The effect of the performance of the assets on the fair value of the liability is asset-specific performance risk, not credit risk. [IFRS 9 Par. B5.7.15]

Determining the effects of changes in credit risk

~~AG197-AG227.~~ For the purposes of applying the requirement in paragraph 104(a)~~5.7.7(a)~~, an entity shall determine the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability either:

- (a) ~~aA~~s the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk (see paragraphs AG228~~B5.7.17~~ and AG229~~B5.7.18~~); or
- (b) ~~uU~~sing an alternative method the entity believes more faithfully represents the amount of change in the liability's fair value that is attributable to changes in its credit risk. [IFRS 9 Par. B5.7.16]

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~~AG198-AG228.~~ Changes in market conditions that give rise to market risk include changes in a benchmark interest rate, the price of another entity's financial instrument, a commodity price, a foreign exchange rate or an index of prices or rates. [IFRS 9 Par. B5.7.17]

~~AG199-AG229.~~ If the only significant relevant changes in market conditions for a liability are changes in an observed (benchmark) interest rate, the amount in paragraph AG227(a)~~B5.7.16(a)~~ can be estimated as follows:

- (a) First, the entity computes the liability's internal rate of return at the start of the period using the fair value of the liability and the liability's contractual cash flows at the start of the period. It deducts from this rate of return the observed (benchmark) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.
- (b) Next, the entity calculates the present value of the cash flows associated with the liability using the liability's contractual cash flows at the end of the period and a discount rate equal to the sum of (i) the observed (benchmark) interest rate at the end of the period and (ii) the instrument-specific component of the internal rate of return as determined in (a).
- (c) The difference between the fair value of the liability at the end of the period and the amount determined in (b) is the change in fair value that is not attributable to changes in the observed (benchmark) interest rate. This is the amount to be presented in ~~other comprehensive income~~net assets/equity in accordance with paragraph 104(a)~~5.7.7(a)~~. [IFRS 9 Par. B5.7.18]

~~AG200-AG230.~~ The example in paragraph AG229~~B5.7.18~~ assumes that changes in fair value arising from factors other than changes in the instrument's credit risk or changes in observed (benchmark) interest rates are not significant. This method would not be appropriate if changes in fair value arising from other factors are significant. In those cases, an entity is required to use an alternative method that more faithfully measures the effects of changes in the liability's credit risk (see paragraph AG227(b)~~B5.7.16(b)~~). For example, if the instrument in the example contains an embedded derivative, the change in fair value of the embedded derivative is excluded in determining the amount to be presented in ~~other comprehensive income~~net assets/equity in accordance with paragraph 104(a)~~5.7.7(a)~~. [IFRS 9 Par. B5.7.19]

~~AG201-AG231.~~ As with all fair value measurements, an entity's measurement method for determining the portion of the change in the liability's fair value that is attributable to changes in its credit risk must make maximum use of relevant observable inputs and minimum use of unobservable inputs. [IFRS 9 Par. B5.7.20]

Definitions

Derivatives

~~AG202-AG232.~~ Typical examples of derivatives are futures and forward, swap and option contracts. A derivative usually has a notional amount, which is an amount of currency, a number of shares, a number of units of weight or volume or other units specified in the contract. However, a derivative instrument does not require the holder or writer to invest or receive the notional amount at the inception of the contract. Alternatively, a derivative could require a fixed payment or payment of an amount that can change (but not proportionally with a change in the underlying) as a result of some future event that is unrelated to a notional amount. For example, a contract may require a fixed payment of CU1,000 if six-month interbank offered rate~~LIBOR~~ increases by 100 basis points. Such a contract is a derivative even though a notional amount is not specified. [IFRS 9 Par. BA.1]

~~AG203~~-AG233. The definition of a derivative in this Standard includes contracts that are settled gross by delivery of the underlying item (e.g. a forward contract to purchase a fixed rate debt instrument). An entity may have 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 (e.g. a contract to buy or sell a commodity at a fixed price at a future date). Such a contract is within the scope of this Standard unless it was entered into and continues to be held for the purpose of delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements. However, this Standard applies to such contracts for an entity's expected purchase, sale or usage requirements if the entity makes a designation in accordance with paragraph 62.5 (see paragraphs 52.4–82.7). [IFRS 9 Par. BA.1]

~~AG204~~-AG234. One of the defining characteristics of a derivative is that it has 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. An option contract meets that definition because the premium is less than the investment that would be required to obtain the underlying financial instrument to which the option is linked. A currency swap that requires an initial exchange of different currencies of equal fair values meets the definition because it has a zero initial net investment. [IFRS 9 Par. BA.3]

~~AG205~~-AG235. A regular way purchase or sale gives rise to a fixed price commitment between trade date and settlement date that meets the definition of a derivative. However, because of the short duration of the commitment it is not ~~recognised~~recognized as a derivative financial instrument. Instead, this Standard provides for special accounting for such regular way contracts (see paragraphs 103.1.2 and AG9B3.1.3–AG12B3.1.6). [IFRS 9 Par. BA.4]

~~AG206~~-AG236. The definition of a derivative refers to non-financial variables that are not specific to a party to the contract. These include an index of earthquake losses in a particular region and an index of temperatures in a particular city. Non-financial variables specific to a party to the contract include the occurrence or non-occurrence of a fire that damages or destroys an asset of a party to the contract. A change in the fair value of a non-financial asset is specific to the owner if the fair value reflects not only changes in market prices for such assets (a financial variable) but also the condition of the specific non-financial asset held (a non-financial variable). For example, if a guarantee of the residual value of a specific car exposes the guarantor to the risk of changes in the car's physical condition, the change in that residual value is specific to the owner of the car. [IFRS 9 Par. BA.5]

Financial assets and liabilities held for trading

~~AG207~~-AG237. Trading generally reflects active and frequent buying and selling, and financial instruments held for trading generally are used with the objective of generating a profit from short-term fluctuations in price or dealer's margin. [IFRS 9 Par. BA.6]

~~AG208~~-AG238. Financial liabilities held for trading include:

- (a) ~~D~~erivative liabilities that are not accounted for as hedging instruments;
- (b) ~~O~~bligations to deliver financial assets borrowed by a short seller (ie an entity that sells financial assets it has borrowed and does not yet own);
- (c) ~~F~~inancial liabilities that are incurred with an intention management model to repurchase them in the near term (eg a quoted debt instrument that the issuer may buy back in the near term depending on changes in its fair value); and

- (d) [Financial liabilities](#) that are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking. [\[IFRS 9 Par. BA.7\]](#)

~~AG209-AG239.~~ The fact that a liability is used to fund trading activities does not in itself make that liability one that is held for trading. [\[IFRS 9 Par. BA.1\]](#)