Revision of GRAP 104 on *Financial Instruments*

Accounting Standards Board

Disclaimer

***The views and opinions expressed in this presentation are those of the individual. Official positions of the ASB on accounting matters are determined only after extensive due process and deliberation*.**

Overview

- Where are we?
- Why change?
- What has changed?
    - How will the accounting be affected?

Where are we?

IAS 32 *Financial Instruments: Presentation*

IPSAS 28

Definitions

Classification of instruments as assets, liabilities and equity

Other presentation issues

IFRS 9 *Financial Instruments*

IPSAS 29

[replaced IAS 39 *Recognition and Measurement]*

Initial recognition and derecognition

Initial and subsequent measurement

Recognition of gains, losses and interest

Hedging

IFRS 7 *Financial Instruments: Disclosures*

IPSAS 30

Disclosures

Classes

Significance of FI for SPER and SPOS

Nature and extent of risks arising from FI

Transfers of FA

GRAP 104

Why change?

The need for better information

IFRS 9 revised because…

- IAS 39 criticised after global financial crisis for providing information too late, particularly on credit losses.
- Use of fair value criticised, particularly for liabilities (impact of own credit risk).
- Classification of financial assets largely rules based.
- Hedging requirements were rules based.

The need for better information

The global financial crisis impacted both the public and private sectors…

- IPSASB revised IPSAS 29 to align with IFRS 9 (IPSAS 41 issued in August 2018).
- IPSASB agreed to maintain alignment with IFRS unless PS reason to depart.

The need for better information

- Work programme consultation indicated review of GRAP 104 needed.
- Highlighted the need to revise classification of assets, impairment and hedging.
- Convergence project or not?
- Where are we in the process?

What has changed?

The starting point

- GRAP 104 *Financial Instruments* based on IAS 32, 39 and IFRS 7.
- Eliminated transactions not relevant to the South African public sector, e.g. equity settled transactions, no hedge accounting, but could apply IAS 39.
- Eliminated alternative accounting treatments.
- Loan commitments and guarantees dealt with separately.

High level changes

Area	Key changes
Scope	Financial guarantee contracts and some loan commitments now in scope.
Initial measurement	Concessionary investments. Credit impaired concessionary loans.
Classification of financial instruments	Based on (a) management model, and (b) characteristics of the contractual cash flows for financial assets. Financial liabilities depends on instrument.
Subsequent measurement	Amortised cost, fair value and cost for some financial assets (no change). Incurred to expected credit loss impairment model. Recognition of gains and losses for own credit risk on designated financial liabilities

High level changes

Area	Key changes
Presentation	Guidance on offsetting financial assets and financial liabilities.
Disclosure	Changes in classification resulted in changes in disclosure. New disclosures on credit risk management practices, evaluation of credit losses on financial performance and position, and credit risk exposure. Offsetting financial assets and financial liabilities.

What is in the scope of GRAP 104?

Scope

- Financial instruments are contractual arrangements that give rise to a financial asset in one entity and a financial liability or residual interest of another.
- Financial asset = cash, contractual right to receive cash or another FA, or exchange FA on favourable conditions.
- Financial liability = contractual right to deliver cash or another FA, or exchange FA on unfavourable conditions.

Scope

Applies to all financial instruments, **except**….

- Interests in controlled entities, joint ventures and associates that are accounted for in GRAP 6, 7 and 8. Applies where those Standards require fair value.
- Leases, except lease receivables (impairment and derecognition), lease liabilities (derecognition).
- Employee benefits.

Scope

- Insurance contracts, except financial guarantee contracts. [new]
- Forward contracts to buy or sell an acquiree not under common control.
- Some loan commitments. [new]
- Reimbursement rights recognised using GRAP 19.
- Initial recognition and initial measurement of contractual receivables in GRAP 23.
- Recognition and measurement of equity instruments issued by an entity.

Scope

- Hedge accounting → no specific guidance in GRAP 104, but can apply relevant IFRS.

Scope

A reminder of items that are <u>not</u> financial instruments:

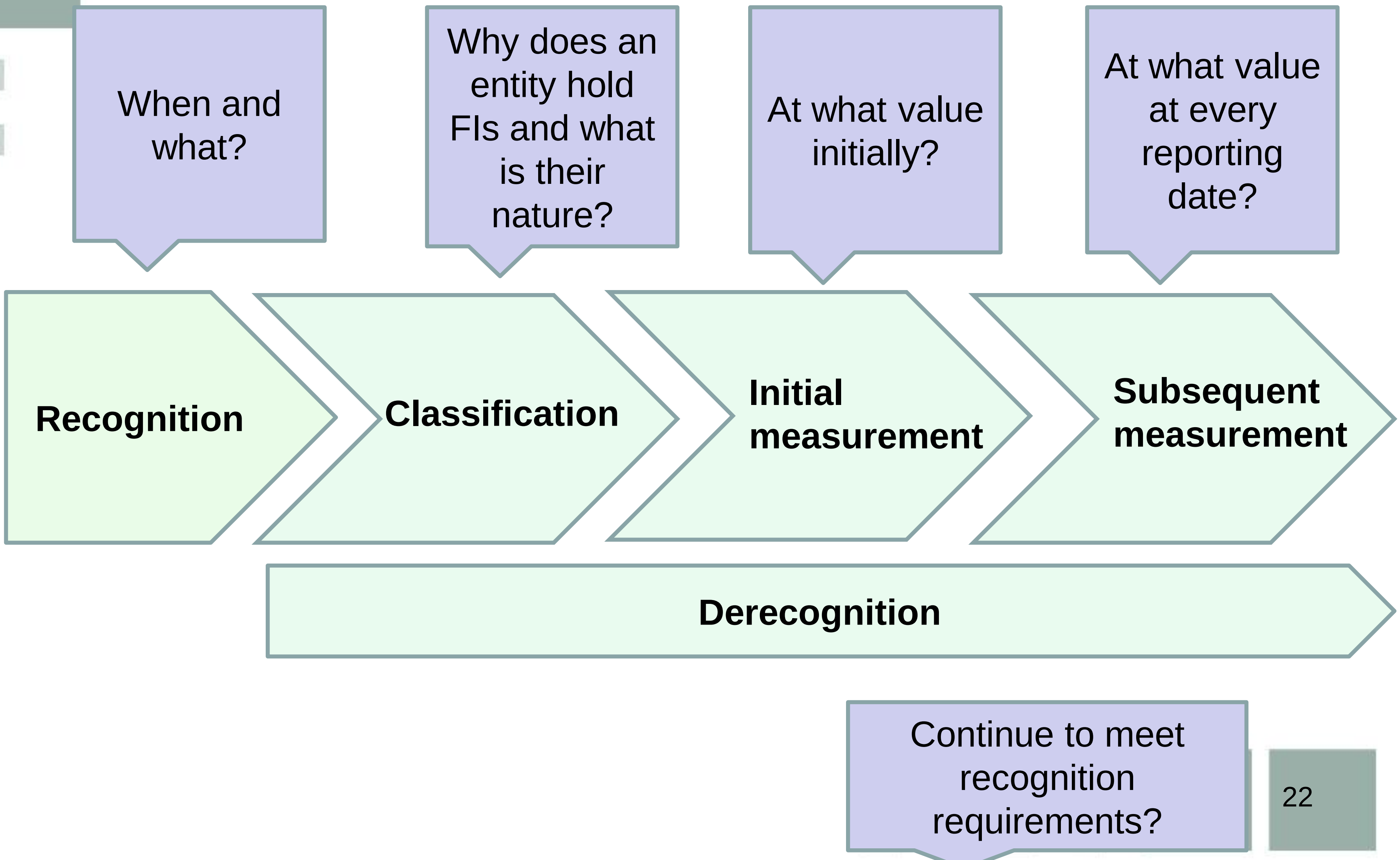
- Prepaid/advance amounts.
- Statutory receivables or payables, e.g. property rates, fines, taxes.

Matter for comment

- Do you agree with the scope?
- Do you agree with the approach to hedge accounting?

Overview of recognition and measurement requirements

The life of a financial instrument

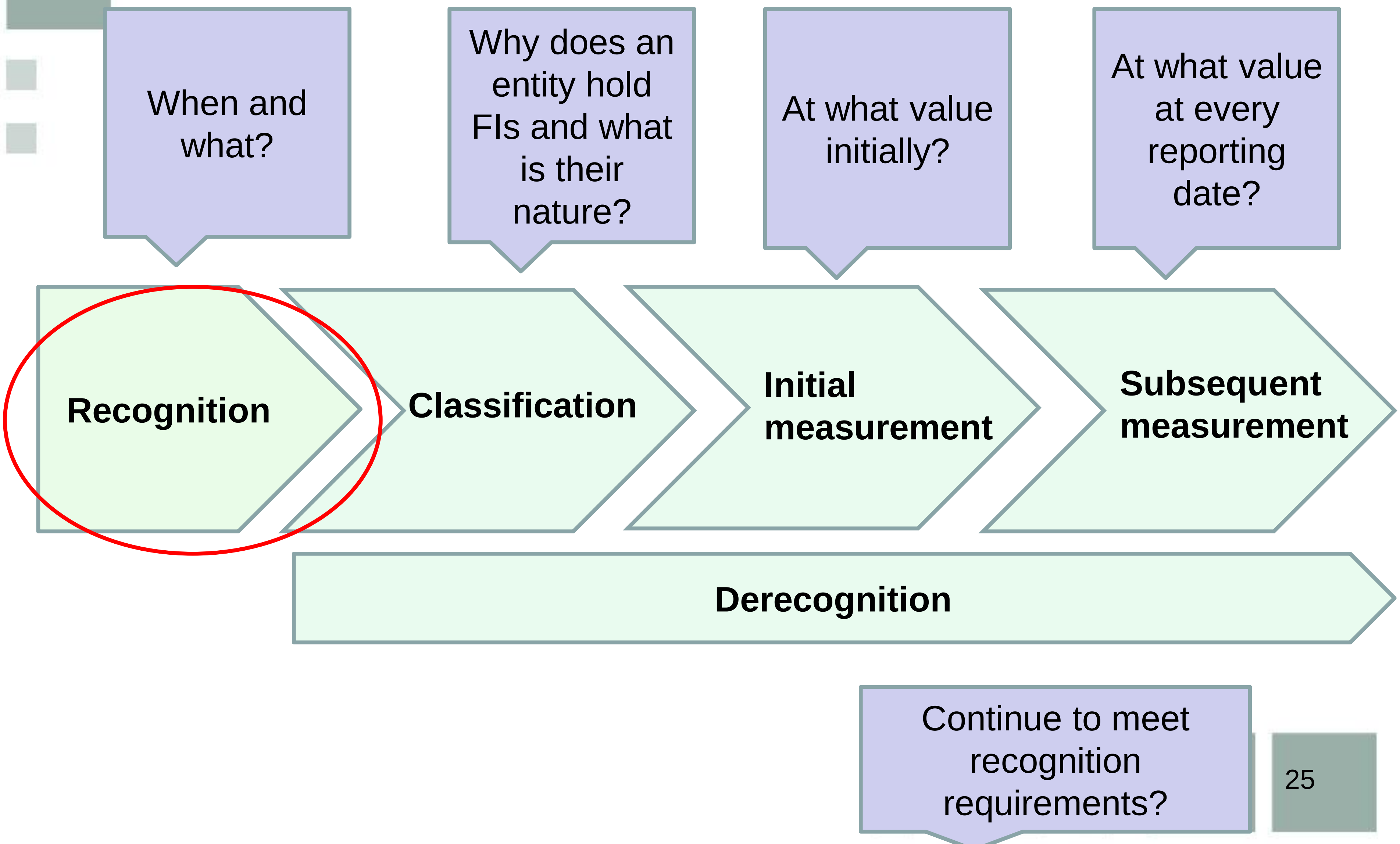


Recognition and measurement

Initial recognition	Financial asset, financial liability or residual interest
	Party to the contractual provisions of the instrument
	Trade date accounting
Classification	Fair value, amortised cost or cost (for some investments in residual interests)
	Financial assets depends on management model of entity and economic characteristics of the instrument
	Financial liabilities amortised cost, unless FV required
	Reclassify FA if management model changes, cost/FV
Initial measurement	Fair value, plus transaction costs if subsequently measured at amortised cost
Subsequent measurement	Expected loss impairment approach for FA at amortised cost
	Incurred loss impairment approach for FA at cost
	Gains and losses in surplus or deficit, except own credit risk

Initial recognition

The life of a financial instrument



When do you recognise?

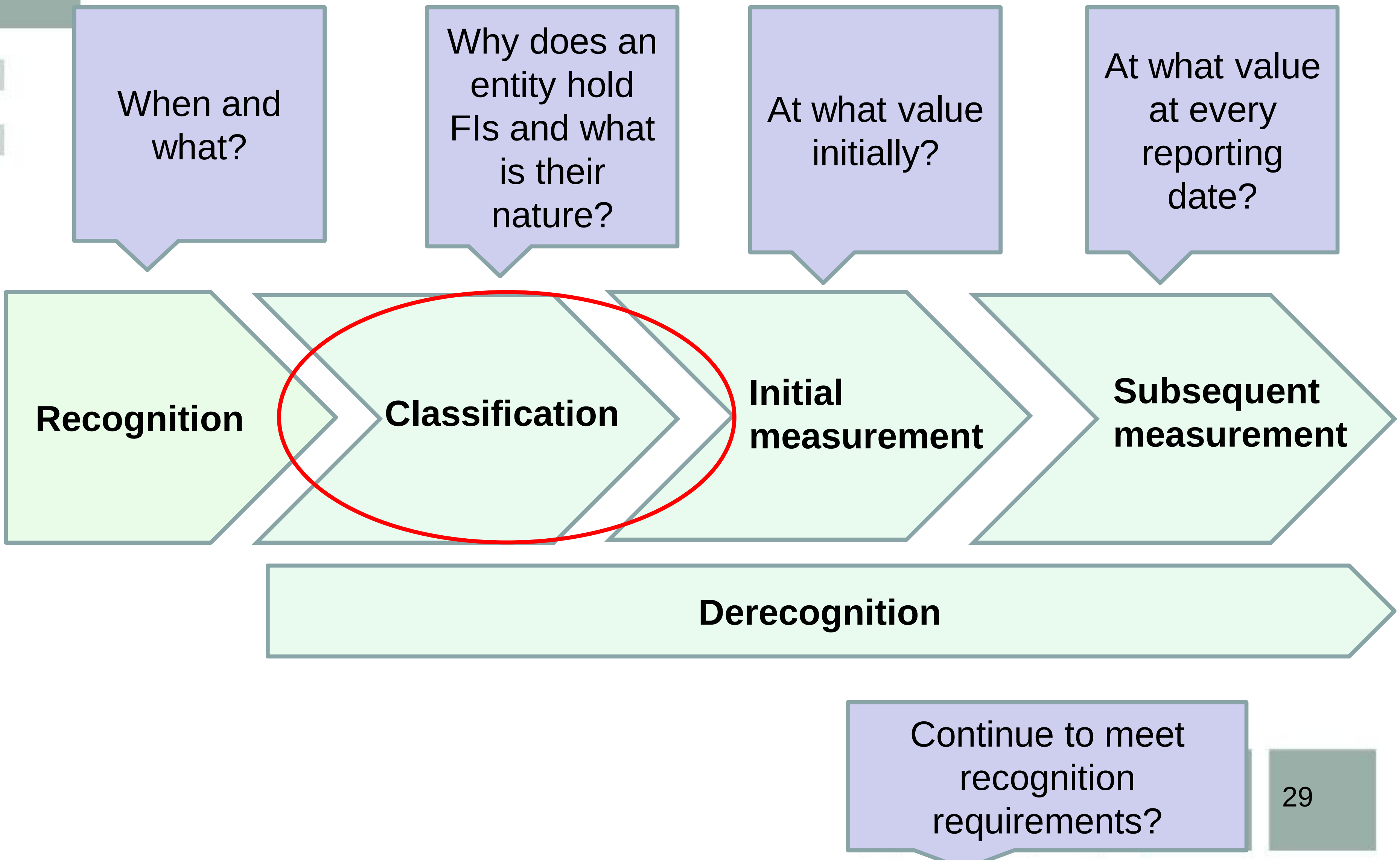
- When an entity becomes party to the contractual provisions of the instrument.
- Regular way purchases or sales at trade date accounting.

What do you recognise?

- Recognise a financial asset, financial liability or residual interest.
- Distinguishing financial liabilities and residual interests:
  - Based on contractual obligation to pay cash.
  - Apply substance over form, e.g. some equity instruments are liabilities and vice versa.
  - Contingent settlement provisions.

Classification of instruments

The life of a financial instrument



Classification

- Classify instruments on initial recognition for subsequent measurement purposes.
- Same number of categories, classification principles substantially changed.

Classification

Financial assets	Fair value **(default)**
	Amortised cost less impairment
	Cost less impairment for investments in residual interests (practical expedient)
Financial liabilities	Amortised cost **(default)**
	Fair value

<table>
<tr><th colspan="3">Classification</th></tr>
<tr><td rowspan="3">Financial assets</td><td rowspan="2">Management model for managing the asset (hold or sell)

Must meet both</td><td>Hold to collect contractual cash flows = amortised cost (if also SPPI)</td></tr>
<tr><td>Hold and sell, or sell = fair value, unless cost.</td></tr>
<tr><td>Characteristics of the asset’s cash flows.</td><td>“Solely payments of principal and interest” = amortised cost (if also held to collect cash flows)</td></tr>
<tr><td>Financial liabilities</td><td>Amortised cost, with some instruments measured at fair value…</td><td>Fair value if:
• Financial liabilities at fair value through S/D (include designated)
• Financial liabilities that arise when asset does not qualify for derecognition or retain continuing involvement
• Financial guarantee contracts
• Loan commitments</td></tr>
</table>

Management model

- Management as defined in GRAP 20.
- Level at which groups of assets are managed together to achieve particular objective → not instrument level, and not reporting entity level.

Management model

- Management model refers to how an entity manages FA to generate cash flows, i.e. collect, sell or both.
- Not based on ‘worst’ or ‘stress’ case.
- Matter of fact and not assertion → observable through activities.

Management model

If hold to collect contractual cash flows, need to look at:

- Frequency, value and timing of sales in prior periods → look at underlying reasons for sales, e.g. sales due to increase in credit risk, close to maturity.
- Sales generally incidental.

Management model

If held to collect and sell, or sell, contractual cash flows:

- An active strategy of selling, rather than incidental sales, e.g. managing daily liquidity.
- Greater frequency and value of sales.

Solely payments of principal and interest

- Principal = fair value on initial recognition
- Interest = consideration for the time value of money, for credit risk associated with the principal amount outstanding, other basic lending risks, and profit margin (if any).
- Interest rates or repayments that include risks or volatility unrelated to a basic lending arrangement not SPPI, e.g. contingent repayment features, leveraged.

Designations at fair value

- Financial assets:

  Can irrevocably designate at fair value to eliminate or reduce accounting mismatch.

- Financial liabilities:

  Eliminate or reduce an accounting mismatch.

  A group of FA and FL is managed, and performance evaluated on a fair value basis i.a.w documented risk management or investment strategy.

Investments in residual interests

- Investments in equity instruments fail SPPI test → fair value.
- As practical expedient, if cannot determine reliable measure of fair value, use cost less impairment.
- Assess on an ongoing basis if fair value available (or not).
- Cost only permitted in rare circumstances in IFRS 9.

Potential impact - Assets

Instrument	GRAP 104	Revised
Bank account	Amortised cost	Amortised cost
Receivables	Amortised cost	Amortised cost
Investments	Amortised cost	Depend on management model and whether SPPI
Loans	Amortised cost	Depend on management model and whether SPPI
Concessionary loans	Amortised cost	Depend on management model and whether SPPI
Investments in equity	Fair value or cost	Fair value or cost

Potential impact - Assets

Consider the following for classification:

- Interest free loan.
- Loan with an inflation linked interest rate.
- Concessionary loan: R100m, 30% capital not repaid, and contractual interest 6% when market 10%.
- Concessionary loan: R100k, only needs to be repaid if borrower finds employment and earns a salary above R300k p.a.

Potential impact - Liabilities

- Expected to be minimal.
- Default is now amortised cost and not fair value.

Embedded derivatives

- Embedded derivative is a component of a hybrid contract that includes a non-derivative host contract.
- Effect is that some of the cash flows vary in a way similar to a derivative instrument, e.g. based on specific interest rate, FI price, commodity price, forex rate, credit rating or credit index.

Embedded derivatives

- If financial asset has an embedded derivative, treat entire contract as a FA.
- If not a financial asset, or financial liability, consider existing principles for separation.
- If separated, the host contract accounted for i.t.o. relevant Standard.
- If required to separate but cannot measure embedded derivative separately at acquisition or subsequently, designate at fair value.

Embedded derivatives

Separate derivative and host contract if:

(a) The economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics of the host.

(b) A separate instrument with the same terms as the embedded derivative would meet the definition of a derivative.

(c) The hybrid contract is not measured at fair value.

Embedded derivatives

Examples

(a) Leases:

- Payments linked to CPI or property index – assume not leveraged and linked to SA environment.
- Contingent rentals based on sales of goods and services.
- Variable interest rates.

(b) Purchases of non-financial items:

- In functional currency of either party.
- Currency in which item is denominated in transactions around the world.
- Currency commonly used to buy or sell item in economic environment on which transaction takes place.

Matter for comment

Do you agree with classification principles?

- Align with IFRS 9, except:
  - No OCI (hold/sell strategy)
  - Investments in residual interests where practical expedient applies?
- Do you agree with the practical expedient for investments in residual interests?

Initial measurement

The life of a financial instrument

When and what?

Why does an entity hold FIs and what is their nature?

At what value initially?

At what value at every reporting date?

Recognition

Classification

Initial measurement

Subsequent measurement

Derecognition

Continue to meet recognition requirements?

Initial measurement

- At fair value, plus or minus transaction costs if not at fair value through S/D.
- Fair value: Amount asset could be exchanged or a liability settled, knowledgeable willing parties in arms length transaction. Not IFRS 13.

Initial measurement

- Fair value assumes an entity is a going concern; no distress or forced sale.
- Best evidence = readily, regularly available prices in active market.
- Price at end of reporting period.
- Price for asset acquired or liability held= ask price.
- Price for asset held or liability to be issued = bid price.
- If no current price, adjust most recent transaction → no change in significant change in circumstances.
- Fair value = no. units X price.
- Fair value could be a rate in valuation technique.

Initial measurement

- If no active market, use valuation technique, including:
  Recent arm's length transaction, reference to current fair value of another instrument that substantially the same, discounted cash flows, option pricing models.
- Valuation technique should maximise market inputs.
- For DCF, rate should equal prevailing rates for similar instruments with same T&Cs, credit quality, remaining term, currency.

Initial measurement

- Same principles apply for subsequent measurement.
- Specific disclosures of how fair value determined & inputs used in determining fair value.

Initial measurement

Where transaction price not equal to fair value (other than concessionary loans), recognise gain or loss:

- Fair value based on quoted price in active market or data from observable market → surplus or deficit.
- Other instances, defer.

Initial measurement

Specific implications for:

- Concessionary loans.
- Concessionary investments.
- Financial guarantee contracts.
- Loan commitments.

Concessionary loans

- Loans on off-market terms (principal, interest or both).
- Loan proceeds ≠ fair value.
- Determine fair value of expected cash flows, using market rate of interest.
- Difference either CFO, non-exchange revenue (borrower/recipient) or social benefit (lender/grantor) – accounted for in terms of Framework.

Concessionary loans

<u>Example</u>

Loan of R100,000 granted by Agency A. R20,000 need not be repaid. Interest of 5% charged when market interest 11%. Fair value on initial recognition is R70,000.

FV = PV of contractual cash flows, discounted at 11%.

Social benefit **R30,000**	**Loan granted (financial asset)** **R70,000**

Concessionary loans

- Specific considerations for concessionary loans that are credit impaired on origination.

[Discuss under impairment section]

Concessionary investments

- Same principle as for concessionary loans.
- When investing in another entity, consider if part of investment non-exchange transaction.
  - Look at terms and conditions of arrangement.
  - If unclear, assume entire transaction an investment in residual interest.

Financial guarantee contracts

- Previously accounted for i.a.w GRAP 19

  - Assess if provision or contingent liability.
- Board agreed that this did not provide adequate information for accountability → agreed to treat as financial instruments.

Financial guarantee contracts

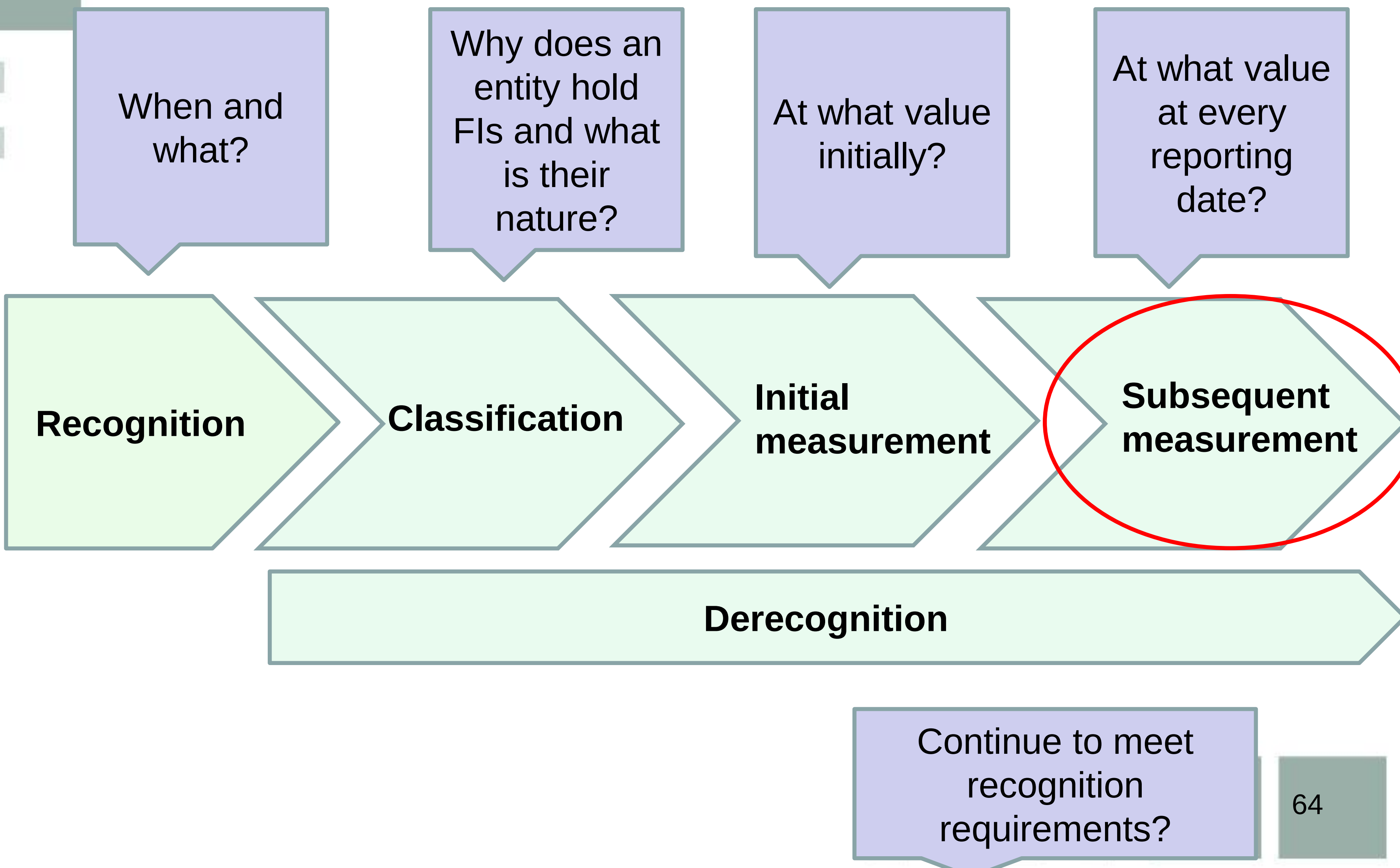
- Fair value usually = guarantee fee.
- If guarantee issued in a non-exchange transaction, determine fair value of fee.
- If no reliable fair value, measure at loss allowance (discuss under impairment section).

Loan commitments

- Commitments to provide loans, particularly on below market terms → GRAP 19.
- Fair value usually = commitment fee.
- If guarantee issued in a non-exchange transaction, determine fair value of fee.
- If no reliable fair value, measure at loss allowance.
- Specific considerations for commitments to provide concessionary loans [discuss under impairment section]

Subsequent measurement

The life of a financial instrument



Subsequent measurement

Assets

- Fair value through surplus or deficit.
- Amortised cost less impairment.
- Cost less impairment.

Liabilities

- Fair value through surplus or deficit.
- Amortised cost.

Amortised cost

Amortised cost

- Substantial changes in the way in which amortised cost calculated, linked to new impairment model.
- Introduction of “credit adjusted effective interest rate” for “purchased or originated credit impaired FA” in calculating amortised cost and impairment.
- Distinction between ‘gross’ and ‘net’ amounts when calculating interest on credit impaired FA.

Amortised cost

Amortised cost is the amount at which a financial asset or financial liability is measured:

	Amortised cost
	Amount at initial recognition
Minus	Principal repayments
Plus or minus	Cumulative amortisation of differences in amount between the initial and maturity amount using the effective interest method
Less (for assets)	Loss allowance
Equals	**Amortised cost**

Gross carrying amount

Amortised cost

Effective interest rate is the rate that exactly discounts estimated future cash payments and receipts through the life of FA or FL to either:

- The gross carrying amount of FA.
- The amortised cost of a FL.

Amortised cost

- Consider all expected cash flows (including fees such as origination & commitment fees, transaction costs, premiums etc), but not expected credit losses….except:

  Purchased or originated credit impaired (POCI) – include credit losses in calculation of credit adjusted effective interest rate.

Note: POCI does not apply to receivables.

Amortised cost

What does it mean to include credit losses initial calculation of effective interest rate?

R100 loan, impaired by R50 when granted.

- Entity will only ever collect R50, therefore future value = R50 on initial recognition.
- R100 loan, becomes impaired by R50 at end of year 1, therefore future value =R100 on initial recognition.

Amortised cost

A FA is credit impaired when one or more events that have a detrimental impact on the estimated future CF have occurred. Evidence includes observable data:

- Significant financial difficulty of issuer or borrower.
- A breach of contract (e.g. past due)
- Lender grants concessions to lender not otherwise consider.
- Probable that borrower will enter bankruptcy.
- Disappearance of an active market for the FA.
- Purchase or origination at a deep discount.

Amortised cost

Interest revenue calculated as:

- Effective interest rate (EIR) X gross carrying amount of financial asset, except:
  - Purchased or originated credit impaired: credit adjusted EIR X amortised cost of financial asset.
  - Credit impaired: EIR X amortised cost of financial asset.

Amortised cost

Guidance on dealing with:

- Modifications – when cash flows modified or renegotiated → recalculate gross carrying amount and recognise gain or loss.
- Write-offs – no reasonable expectation of recovering asset → derecognition event.
  - Interaction between write-off and impairment allowance.
  - Legal write off versus accounting.

Impairment approach

Impairment – the basics

- Change in impairment model from *incurred* to *expected* losses.
- Recognise a loss allowance for expected credit losses for:

  FA at amortised cost

  Receivables

  Lease receivables

  Financial guarantees and loan commitments

Impairment – the basics

- Impairment gain or loss = amount of expected credit losses (ECL) to adjust the loss allowance [based on either lifetime or 12 month losses] at reporting date.
- ECL: weighted average of credit losses with the respective risks of a default occurring as the weights.

Impairment – the basics

Value of loss allowance depends on whether significant increase in credit risk since initial recognition:

- Significant increase = Lifetime expected credit losses.
- No significant increase = 12 month expected credit losses.

Impairment – the basics

- 12 month: ECL that result from default events that are possible within 12 months of reporting date.
- 12 month ECL:

  ≠cash shortfalls over 12 month period

  =entire credit loss on an asset weighted by the probability that the loss will occur in next 12 months.

Impairment – the approach

Approach has two steps:

1. Determine whether there has been a significant change in credit risk, i.e. change in risk of default occurring → whether use 12 month of lifetime ECL.
2. Determine the amount of the expected credit losses.

Receivables and lease receivables – use lifetime ECL → no step 1.

Impairment – the approach

Step 1: Determining increases in credit risk

- Change in risk of default occurring over life of instrument, not amount of credit losses.
- Compare risk of default occurring at initial recognition vs reporting date.
- Default defined using internal credit management policy. Assume default does not occur later than 90 days past due.

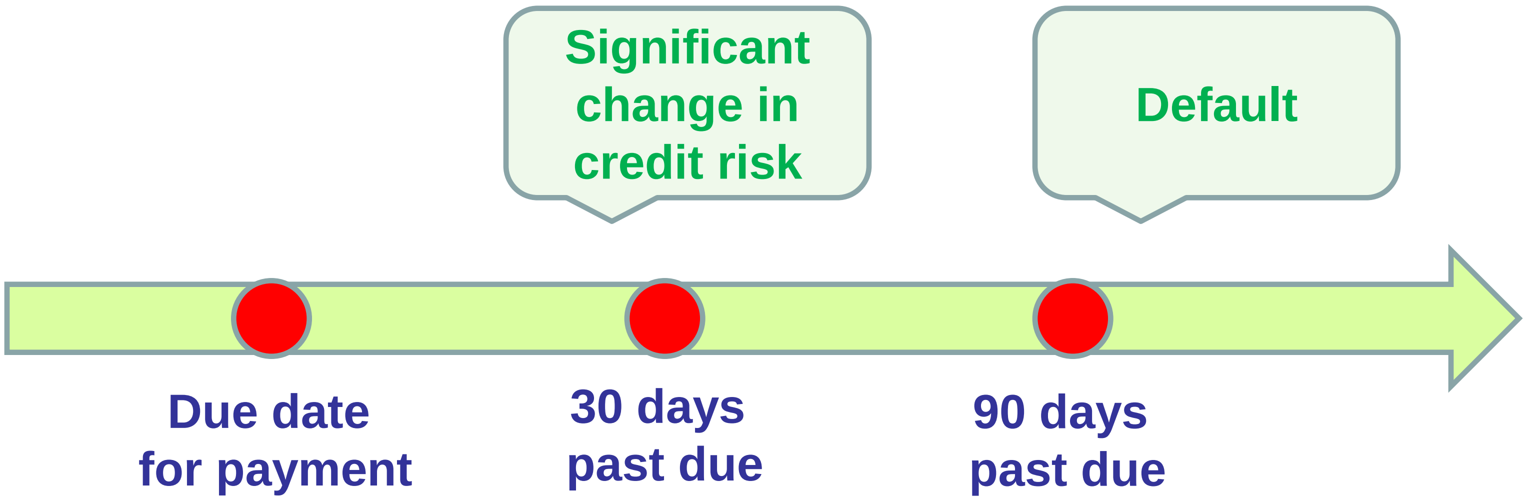
Impairment – the approach

Step 1: Determining increases in credit risk

- Assessment based on reasonable and supportable information available without undue cost or effort.
- Rebuttable presumption that credit risk increased significantly if 30 days past due.

Impairment – the approach

Rebuttable assumptions



Impairment – the approach

Step 1: Determining increases in credit risk

- Individual or collective basis → information may not be available for individual before becomes past due.
- Group assets when they have common risk characteristics, e.g. instrument type, credit risk ratings, collateral type, date of initial recognition, remaining maturity, industry, geographical location of borrower.

Impairment – the approach

Step 1: Determining increases in credit risk

Indicators that may be relevant in assessing changes in credit risk:

- Actual or expected change in external credit rating, or internal credit rating downgrade.
- Existing or forecast changes in business, financial or economic conditions / regulatory, technological, economic environment that affect ability to meet debt obligations, e.g. increase in interest rates, decline in demand for goods/services.
- Increase in credit risk of other financial instruments of same borrower.
- Reduction of support from controlling entity.
- Etc…

Impairment – the approach

Step 1: Determining increases in credit risk

- Assume no significant increase in credit risk if instrument has low credit risk.

Impairment – the approach

Step 2: Determining expected credit losses

- Probability weighted estimate of credit losses over the life of instrument.
- Credit loss is PV of difference between cash flows (CF) due under contract vs amount an entity expects to receive.
- Consider <u>what</u> CF an entity expects to receive, and <u>when</u> they will be received.
- Discounted using EIR or CAEIR.

Impairment – the approach

Step 2: Determining expected credit losses

- Assessment based on reasonable and supportable information, available without undue cost or effort, about past events, current conditions and forecasts of future economic conditions.
- Consider economic conditions of borrower, general economic conditions, and current & forecast conditions.
- Use internal and external data, peer group data if none available.

Impairment – the approach

Step 2: Determining expected credit losses

- Include collateral in calculation of expected cash flows, unless will not be utilised.
- For receivables, can use a provisioning matrix based on historical credit loss experience.

Impairment - summary

	Level 1	Level 2	Level 3	
Status	No significant change in credit risk, not impaired.	Significant change in credit risk since initial recognition	Credit impaired after initial recognition	Credit impaired on purchase or origination
Interest rate	Effective interest rate	EIR	EIR	Credit adjusted effective interest rate
Revenue	EIR X gross CA	EIR X gross CA	EIR X amortised cost	CAEIR X amortised cost
Period over which losses calculated	12 month ECL	Lifetime ECL	Lifetime ECL	Lifetime ECL

Impact

- Data about credit risk of counterparty.
- Probability weighted assessment.
- Loss information → historical, present and forward looking.
- Receivables → can apply practical expedient for assessing credit risk, and provision matrix for loss allowances.
- Considerations for financial guarantees, concessionary loans and loan commitments.

Impact

Example of a provision matrix

Goods and services provided	Current	1–30 days past due	31–60 days past due	61–90 days past due	More than 90 days past due
Households	1%	2.5%	5.5%	8%	14%
Industrial	0.3%	1.6%	3.6%	6.6%	10.6%

Based on probabilities and loss rates in each class of receivables, using both historical and forward looking data.

Financial guarantees

- Measured initially at fair value.
- If no reliable measure of fair value initially, use loss allowance.
- Subsequent measurement higher of:
  - Deferred revenue less amount recognised
  - Loss allowance

Concessionary loans

- Measured initially at fair value = PV of contractual cash flows using EIR (market rate).
- What if concessionary loan is credit impaired on origination?
- Fair value = PV of expected cash flows, including credit losses, using CAEIR.
- “Social benefit” component = concessionary element + credit losses.
- Disclosure of info on nominal cash flows.

Concessionary loans

<u>Example</u>

- 5 year loan of R100,000 granted by Agency A. R20,000 need not be repaid. Credit impaired based on previous loans provided, loss rate 50%. Fair value on initial recognition is R35,000. Assume market interest charged.

Social benefit R65 000 [capital forgiven, plus credit losses]	Loan granted (financial asset) R35,000

Loan commitments

- Commitments to provide loans on below market terms in scope of revised Standard.
- Initial measurement = fair value.
- Where no commitment fee charged on initial recognition and no reliable measure of FV → loss allowance.
- Subsequent measurement higher of:
  - Deferred revenue less amount recognised
  - Loss allowance

Loan commitments

Loan commitments for concessionary loans:

- Where no commitment fee charged, recognise loss allowance and concessionary component of loan together.
- Where commitment fee charged, higher of:

    Deferred revenue less amount recognised

    Loss allowance plus concessionary component of loan.

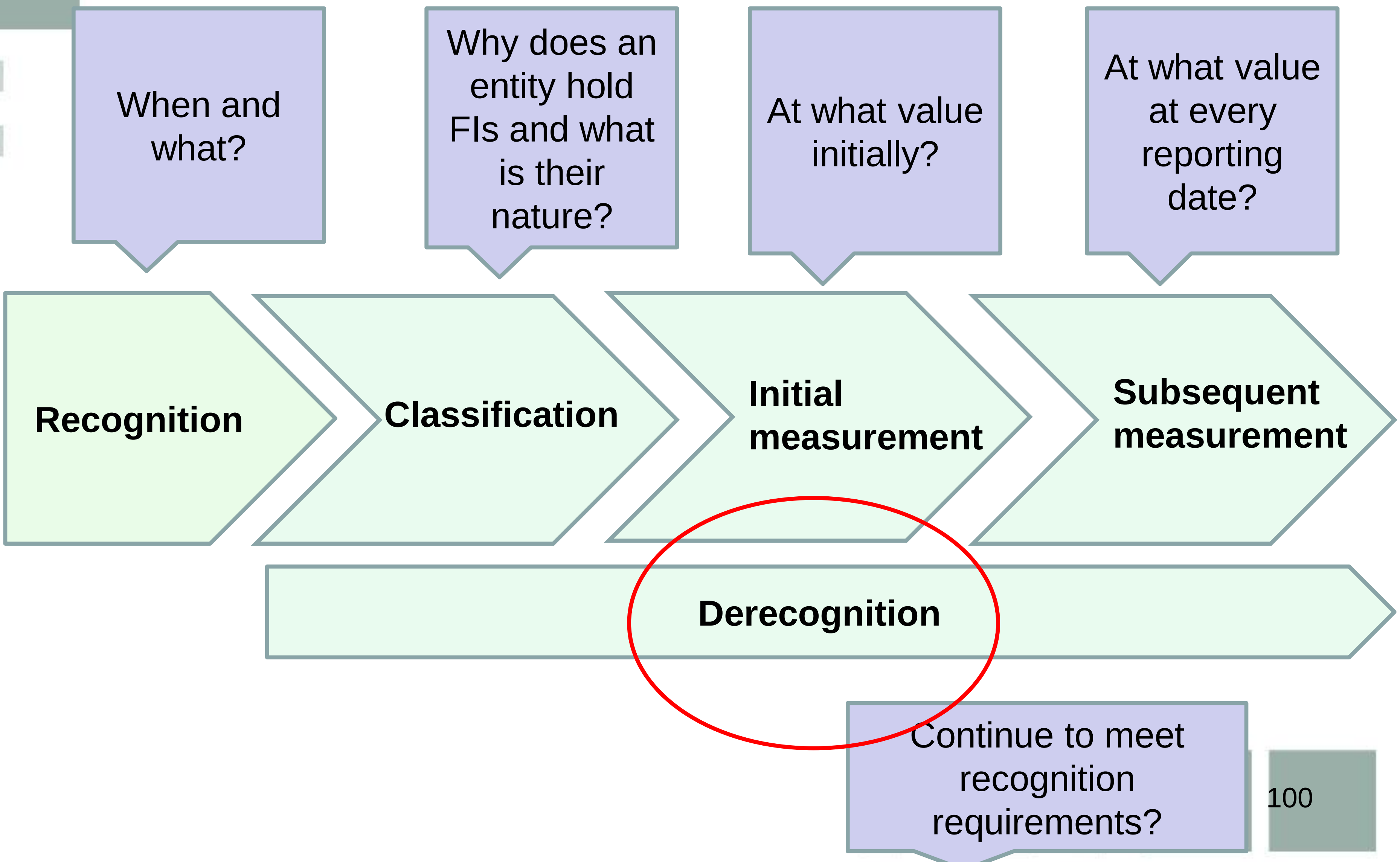
Matter for comment

Do you agree with:

- New principles for amortised cost?
- Expected credit loss approach to impairing financial assets?
- Excluding receivables from POCI requirements?

Derecognition

The life of a financial instrument



Derecognition of assets

- Contractual rights to the cash flows expire, settled or are waived.
- Transfer substantially all risks and rewards of ownership to the FA.
- Retains significant risks and rewards, but transfers control to another party and has the practical ability to sell the instrument →CA of amount of FA allocated between rights retained and transferred. New rights/obligations recognised at fair value.

Derecognition of liabilities

- Liabilities derecognised when extinguished, i.e. discharged, cancelled or expires.
- Exchanges of debt instruments or modifications of debts instruments that result in 10% difference in PV

Disclosures

Disclosures	
Objective	**Information**
Classes of FI and level of disclosure	Disclosure by class based on nature of information disclosed and characteristics of instruments. Sufficient info to permit reconciliation to FS.
Significance of FI POS	Evaluate significance of FA and FL to PER and POS.
	CA of instruments, classified at FV (showing designated separately), amortised cost
	Information about instruments designated at fair value (info about credit risk)
	Reclassifications of financial assets Offsetting arrangements
	Derecognition (transfers of assets where do not qualify for derecognition)
	Collateral and its value and use Compound financial instruments with multiple embedded derivatives
	Concessionary loans and investments

Disclosures

Objective	Information
Significance of FI PER	Revenue, expenses, gains and losses on different categories of instruments
Notes to FS	Fair value disclosures not required When fair value used, need to disclose information about method and assumptions Level of inputs used in fair value hierarchy when valuing instruments
Nature and extent of risks arising from FI	Nature and extent of risks arising from FI at reporting date
	Qualitative disclosures – exposures to risks and how measured & managed.
	Quantitative disclosures – summary of quantitative data at reporting date, and concentrations of risk Credit risk disclosures – practices, expected credit losses exposure, collateral
	Liquidity risk and market risk

Matter for comment

Do you agree with:

- Existing disclosure on whether collateral held is sufficient for debts owing?
- New disclosures?

Impact on specific transactions

Receivables and payables

Receivables

Description	• Contractual rights to receive cash. Rights to receive goods or services not FA. • Can arise from exchange and non-exchange transactions. • Receivables that arise from legislation are not FA → GRAP 108.
Scope	• In GRAP 104. For receivables from non-exchange transactions, recognition and initial measurement in GRAP 23. • Rights to payments to reimburse the entity for expenditure it is required to make to settle a liability (GRAP 19). • Lease receivables → subject to impairment, derecognition, presentation and disclosure.
Recognition	Become party to contractual provisions of the instrument, e.g. when entity provides goods and services on credit.
Classification	• Assess management model (hold, sell) and characteristics of cash flows (SPPI test). • Amortised cost = hold to collect cash flows and SPPI criteria met. • Fair value = hold+sell, or sell and/or cash flows do not meet SPPI. Only amortised cost illustrated.

Receivables

Initial measurement	• Fair value plus transaction costs. • Fair value usually equals transaction price, i.e. consideration to be received. Consider if any off-market elements exist, e.g. interest free periods, interest not market related. • No discounting if interest free credit period consistent with terms in public sector. • As a practical expedient, may use prime lending rate for groups of receivables (adjusted for any specific risks). Government bond rate can be used for debts owing by government entities.
Subsequent measurement	**Amortised cost** Amount initially recognised (FV + trans costs) Minus Principal repayments Plus or minus Cumulative amortisation Adjusted for Loss allowance
Loss allowance	Credit loss = PV of contractual cash flows – PV of expected cash flows Practical expedients for receivables: • Use lifetime expected credit losses. • Can use provision matrix.

Receivables

Loss allowance	• Expected credit losses based on unbiased, probability weighted amounts. • Use reasonable and supportable information about past, current and future events, available without undue cost or effort. • Discounted using effective interest rate at initial recognition. No “purchased or originated credit impaired” requirements for receivables.
Interest revenue	Based on whether credit impaired or not (definition). Not credit impaired: Gross carrying amount X EIR Credit impaired: Amortised cost X EIR
Derecognition	Derecognise in part or entirety when: • Contractual cash flows have expired, are settled or waived; • Entity transfers to another party substantially all of the risks and rewards of ownership of FA; or • Retained significant risks and rewards but transferred control to another party, and that party has the practical ability to sell the asset to an unrelated third party. • Derecognition versus modification.

Payables

Description	• Contractual rights to pay cash. Rights to give goods or services not FL. • Can arise from exchange and non-exchange transactions. • Payables that arise from legislation are not FL → GRAP 19.
Scope	• In GRAP 104. • Liabilities related to employee benefits in GRAP 25.
Recognition	Become party to contractual provisions of the instrument, e.g. when entity receives goods and services on credit.
Classification	Amortised cost unless: • Payable qualifies to be measured at fair value through surplus or deficit. • Payable is a FL recognised because the asset does not qualify for derecognition.
Initial measurement	• Fair value plus transaction costs. • Fair value usually equals transaction price, i.e. consideration to be received. Consider if any off-market elements exist, e.g. interest free periods, interest not market related.

Payables

Initial measurement	• No discounting if interest free credit period consistent with terms in public sector. • As a practical expedient, may use prime lending rate for groups of payables (adjusted for any specific risks). Government bond rate can be used for debts owing to government entities.
Subsequent measurement	**Amortised cost** Amount initially recognised (FV + trans costs) Minus Principal repayments Plus or minus Cumulative amortisation
Interest expense	Gross carrying amount X EIR
Derecognition	• Obligation is discharged, cancelled, expires or waived. • When terms are revised (renegotiated), consider if liability should be derecognised. Derecognise if discounted cash flows on new terms more than 10% different from the discounted PV of remaining cash flows of the original liability → recognise new. Also consider if new liability a concessionary loan. • Gain or loss in surplus or deficit.

Concessionary loans

Concessionary loans issued

Description	• Contractual rights to receive cash. • Concessionary loans granted or received by an entity on terms that are not market related. • Concessionary loans provided by government to achieve particular policy objectives.
Scope	• In GRAP 104. • Loan component = financial asset. • Non-exchange component = social benefit → use Framework.
Recognition	Become party to contractual provisions of the instrument. Could be at loan commitment.
Classification	• Assess management model (hold, sell) and characteristics of cash flows (SPPI test). • Amortised cost = hold to collect cash flows and SPPI criteria met. • Fair value = hold+sell, or sell and/or cash flows do not meet SPPI. Consider whether any features not consistent with basic lending arrangement. In particular, certain contingent repayment features. Interest free loans will not automatically fail SPPI criteria.

Concessionary loans issued

Initial measurement - Not credit impaired on origination	• Fair value plus transaction costs if at amortised cost. • Fair value of loan = PV of expected contractual cash flows discounted using market interest rate for a similar instrument. • Social benefit = Loan proceeds – FV of loan. • Market rate = rate for similar instrument, with similar term, currency, risk, T&Cs. • As a practical expedient, may use prime lending rate for groups of receivables (adjusted for any specific risks). Government bond rate can be used for debts owing by government entities.
Initial measurement – Credit impaired on origination	• Credit impaired based on definition. • Fair value of loan = PV of contractual cash flows an entity expects to receive, <u>including credit losses,</u> discounted using market interest rate for a similar instrument. • High degree of judgement in determining market interest rate for already impaired concessionary loans. Where no reliable fair value → use rate that best represents time value of money.

Concessionary loans issued

Subsequent measurement	Either amortised cost or fair value → based on classification criteria.
Subsequent measurement	**Amortised cost** Amount initially recognised (FV + trans costs) Minus Principal repayments Plus or minus Cumulative amortisation* Adjusted for Loss allowance * Can be either EIR or credit adjusted effective interest rate.
Loss allowance	Credit loss = PV of contractual cash flows – PV of expected cash flows In calculating expected credit losses, two step approach: 1. Use 12 month or lifetime ECL based on whether significant change in credit risk since initial recognition. 2. Measure expected credit losses.

Concessionary loans issued

Loss allowance	Step 1 • Significant change in credit risk, i.e. change in risk of default occurring (individual and collective assessment). • Significant change = use lifetime ECL. • No significant change = 12 month ECL. • Rebuttable presumptions: *Credit risk has increased if contractual payments more than 30 days past due.* *Default does not occur later than when FA is 90 days past due.*
	Step 2 • Expected credit losses based on unbiased, probability weighted amounts. • Use reasonable and supportable information about past, current and future events, available without undue cost or effort. • Discounted using effective interest rate at initial recognition.
Subsequent measurement	**Fair value** Expected contractual cash flows X market interest rate at each reporting date. Changes in fair value in surplus or deficit.

Concessionary loans issued

Interest revenue	Based on whether credit impaired or not (definition). Not credit impaired: Gross carrying amount X EIR Credit impaired: Amortised cost X EIR Credit impaired on origination: Amortised cost X CAEIR
Derecognition	Derecognise in part or entirety when: • Contractual cash flows have expired, are settled or waived; • Entity transfers to another party substantially all of the risks and rewards of ownership of FA; or • Retained significant risks and rewards but transferred control to another party, and that party has the practical ability to sell the asset to an unrelated third party. • Derecognition versus modification.

Concessionary loans received

Description	• Contractual rights to pay cash. • Concessionary loans granted or received by an entity on terms that are not market related. • Concessionary loans provided by government to achieve particular policy objectives.
Scope	• In GRAP 104. • Loan component = financial liability. • Non-exchange component = CFO or non-exchange revenue → use GRAP 23.
Recognition	Become party to contractual provisions of the instrument.
Classification	Amortised cost, unless qualify to measure at fair value (e.g. designated).

Concessionary loans received

Initial measurement	• Fair value plus transaction costs. • Fair value = present value of contractual cash flows discounted using market rate for a similar instrument (same T&Cs, currency, term, risk). Liability = PV of contractual cash flows discounted using market rate. CFO or non-exchange revenue = Proceeds – liability component.
Subsequent measurement	Most concessionary loans measured at amortised cost **Amortised cost** Amount initially recognised (FV + trans costs) Minus Principal repayments Plus or minus Cumulative amortisation
Interest expense	Gross carrying amount X EIR

Concessionary loans received	
Derecognition	• Obligation is discharged, cancelled, expires or waived. • When terms are revised (renegotiated), consider if liability should be derecognised. Derecognise if discounted cash flows on new terms more than 10% different from the discounted PV of remaining cash flows of the original liability → recognise new. • Gain or loss in surplus or deficit.

Financial guarantees

Financial guarantees issued

Description	• Financial guarantee is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtors fails to make payment i.a.w with the terms of a debt instrument. • Performance guarantees, e.g. where entity agrees to make payments because an insufficient level of revenue is generated from an activity, are not financial instruments. Apply GRAP 19. • Government as “lender of last resort” → not financial guarantee.
Scope	• In GRAP 104.
Recognition	Become party to contractual provisions of the instrument, i.e. when financial guarantee is issued.
Classification	Fair value initially, with specific measurement requirements.

Financial guarantees issued

Initial measurement	• Fair value = fee received for issuing guarantee. • Where no guarantee fee charged, or fee not fair value → determine fair value. • Fair value = fee for a similar guarantee, or using valuation technique. • Where no reliable fair value, initial measurement = loss allowance.
Subsequent measurement	Higher of: • Fair value less cumulative amortisation (if applicable); and • Loss allowance.
Loss allowance	Apply same principles as financial assets.

Financial guarantees issued

Derecognition	• Obligation is discharged, cancelled, expires or waived. • When terms are revised (renegotiated), consider if liability should be derecognised. Derecognise if discounted cash flows on new terms more than 10% different from the discounted PV of remaining cash flows of the original liability → recognise new. • Gain or loss in surplus or deficit.

Financial guarantees received

Overview	• Financial instruments, but not recognised by the holder. • Included any calculations of expected credit losses in determining loss allowance of debt that is guaranteed. • Guarantees in place would impact on whether credit impaired on origination or not.

Loan commitments

Loan commitments

Description	Firm commitment to provide credit under specified terms and conditions. Accounting implications for issuer.
Scope	Impairment and derecognition requirements apply to all loan commitments. The following loan commitments are subject to all the requirements of GRAP 104: • Designated at fair value through surplus or deficit. • Commitments settled net in cash or by issuing or delivering another financial instrument. • Commitments to provide loans on below market terms, including concessionary loans.
Recognition	Become party to contractual provisions of the instrument, i.e. when loan is issued.
Classification	Fair value initially, with specific measurement requirements subsequently.

Loan commitments

Initial measurement	**Loan commitments** • Fair value = fee received for issuing loan commitment. • Where no commitment fee charged, or fee not fair value → determine fair value. • Fair value = fee for a similar commitment, or using valuation technique. • Where no reliable fair value, initial measurement = loss allowance.
Initial measurement	**Commitments to provide concessionary loans** Sub-set of “below market loans”, but provided to achieve specific public policy objectives. Initial measurement includes both the loss allowance (above) and value of social benefit provided. EIR does not change with every draw down.
Subsequent measurement	Higher of: • Fair value less cumulative amortisation (if applicable); and • Loss allowance. If commitment for concessionary loan, only loss allowance changes.

Loan commitments

Loss allowance	Apply same principles as financial assets.
Derecognition	• Obligation is discharged, cancelled, expires or waived. • When terms are revised (renegotiated), consider if liability should be derecognised. Derecognise if discounted cash flows on new terms more than 10% different from the discounted PV of remaining cash flows of the original liability → recognise new. • Gain or loss in surplus or deficit.

Investments in residual interests

Investments in residual interests

Description	Residual interest = contract that represents an interest in the assets of one entity after deducting all the liabilities. A residual interest includes contributions from owners which may be evidenced by: • Equity instruments or similar unitised capital. • Formal designation of a transfer of resources by the parties to the transaction. • Formal agreement, establishing or increasing an existing interest.
Scope	• Investments in residual interests are financial assets. Accounting requirements differ depending on whether entity, separate or consolidated financial statements. • Where controlled entity, joint venture or associate, apply GRAP 6-8 → except if fair value required in those Standards.
Recognition	Become party to contractual provisions of the instrument. Consider whether regular way purchase or sale → trade date accounting.
Classification	Investments in residual interests do not meet SPPI test → fair value through surplus or deficit.

Investments in residual interests

Initial measurement	• Fair value, plus transaction costs if not subsequently measured at fair value. • Fair value is the price paid between a willing buyer and a willing seller in an arms length transaction. • Fair value determined using quoted price in an active market, or a valuation technique. • Difference between fair value and transaction price (if any) recognised in surplus or deficit (level 1 inputs or valuation using only observable inputs), deferred (other).
Subsequent measurement	Fair value at each reporting date. If no reliable measure of fair value, can use cost less impairment as a practical expedient.
Loss allowance	Based on incurred loss model → using criteria in definition of credit impaired financial asset. Impairment loss = CA of financial asset – PV of estimated future cash flows discounted at the current market rate of return for a similar asset. Impairment losses cannot be reversed.

Investments in residual interests

Derecognition	Derecognise in part or entirety when: • Contractual cash flows have expired, are settled or waived; • Entity transfers to another party substantially all of the risks and rewards of ownership of FA; or • Retained significant risks and rewards but transferred control to another party, and that party has the practical ability to sell the asset to an unrelated third party. • Derecognition versus modification. Consider trade date accounting, if relevant.

Investments and issued loans

Investments and issued loans

Description	A loan issued by an entity, or an investment made by an entity in another (e.g. bonds, deposits, treasury bills etc.), are contractual rights to receive cash.
Scope	In GRAP 104 (investments in residual interests need to be considered separately).
Recognition	Become party to contractual provisions of the instrument (consider if trade date relevant).
Classification	• Assess management model (hold, sell) and characteristics of cash flows (SPPI test). • Amortised cost = hold to collect cash flows and SPPI criteria met. • Fair value = hold+sell, or sell and/or cash flows do not meet SPPI. Consider whether any features not consistent with basic lending arrangement. In particular, certain contingent repayment features. Interest free loans will not automatically fail SPPI criteria.

Investments and issued loans

Initial measurement	• Fair value plus transaction costs if at amortised cost. • Fair value is the price paid between a willing buyer and a willing seller in an arms length transaction. • Fair value determined using quoted price in an active market, or a valuation technique. • Difference between fair value and transaction price (if any) recognised in surplus or deficit (level 1 inputs or valuation using only observable inputs), deferred (other).
Subsequent measurement	Either amortised cost or fair value → based on classification criteria.

Investments and issued loans

Subsequent measurement	**Amortised cost** Amount initially recognised (FV + trans costs) Minus Principal repayments Plus or minus Cumulative amortisation* Adjusted for Loss allowance * Can be either EIR or credit adjusted effective interest rate.
Loss allowance	Credit loss = PV of contractual cash flows – PV of expected cash flows In calculating expected credit losses, two step approach: 1. Use 12 month or lifetime ECL based on whether significant change in credit risk since initial recognition. 2. Measure expected credit losses.

Investments and issued loans

Loss allowance	<u>Step 1</u> • Significant change in credit risk, i.e. change in risk of default occurring (individual and collective assessment). • Significant change = use lifetime ECL. • No significant change = 12 month ECL. • Rebuttable presumptions: *Credit risk has increased if contractual payments more than 30 days past due.* *Default does not occur later than when FA is 90 days past due.*
	<u>Step 2</u> • Expected credit losses based on unbiased, probability weighted amounts. • Use reasonable and supportable information about past, current and future events, available without undue cost or effort. • Discounted using effective interest rate at initial recognition.
Subsequent measurement	**Fair value** Expected contractual cash flows X market interest rate at each reporting date.

Investments and issued loans

Interest revenue	Based on whether credit impaired or not (definition). Not credit impaired: Gross carrying amount X EIR Credit impaired: Amortised cost X EIR Credit impaired on origination: Amortised cost X CAEIR
Derecognition	Derecognise in part or entirety when: • Contractual cash flows have expired, are settled or waived; • Entity transfers to another party substantially all of the risks and rewards of ownership of FA; or • Retained significant risks and rewards but transferred control to another party, and that party has the practical ability to sell the asset to an unrelated third party. • Derecognition versus modification.

Matter for comment

- Are there any regulatory or other issues that need to be considered or may affect implementation of the Standard?
- Should the National Treasury develop implementation guidance (in addition to GRAP Guide)?
- Would amendments result to GRAP 104 result in information that is useful to users of financial statements?

Comment process

- Comment deadline 7 December 2018.
- Board discuss March 2019.
- Thereafter, develop transitional provisions and discuss possible effective date.

Questions and comments?

Stakeholder outreach and communication

Outreach activities

- Continuous promotion of GRAP by improving outreach to stakeholders (workshops, meetings, seminars, SAICA webinars)
- Stakeholders should liaise with ASB when requiring any engagements
- Newsletters & Meeting Highlights
- Handbook

Translation

- Standards translated into isiZulu, Sesotho and Afrikaans
- The official version is the English language version
- Available on website

Website

- Overview of changes made to reporting framework for 2018 onwards.
- Three set of Standards:
  - Those entities with a December year-end
  - The Standards applicable for the current year
  - The Standards applicable for the next financial year
- Please register on website if you want to be advised of changes:

  http://www.asb.co.za/GRAP/Subscribe-to-email-alerts

Submitting comments

Visit our website for more information on these Exposure Drafts

www.asb.co.za

Submit your comments to
info@asb.co.za

THANK YOU

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