Accounting Standards Board

Key differences between existing and proposed requirements of GRAP 104

	Requirement of GRAP 104		Potential impact	Users information needs
	Existing	**Proposed**		
Scope	Financial guarantee contracts issued by an entity are recognised and measured, and/or disclosed in accordance with GRAP 19.	Financial guarantee contracts are in the scope of GRAP 104 and are accounted for as follows: *Initial measurement* Financial guarantee contracts are measured initially at fair value. Where a financial guarantee is issued in a non-exchange transaction and there is no reliable measure of fair value, initial measurement is based on the loss allowance determined by applying the new impairment model. *Subsequent measurement* At the higher of: (a) fair value, less any revenue recognised; and (b) the loss allowance determined using the new impairment model.	In terms of the current requirements, an issuer of a financial guarantee would have either recognised a provision (if the outflow of economic benefits or service potential was probable), or disclosed a contingent liability. Under the proposed revisions, the issuer of a guarantee will recognise the fair value of the guarantee when the entity becomes party to the contract. The fair value is usually equal to the fee charged to issue the guarantee. If a fair value cannot determined, particularly for those transactions that are issued in a non-exchange transaction (i.e. no, or only a nominal fee charged), the initial measurement is based on the loss allowance. The allowance reflects the credit losses that the issuer expects to incur over either the next 12 months or the period of the contract. After initial recognition, the issuer measures the guarantee at the higher of the fee received, less any revenue recognised, and the loss allowance.	While there are a limited number of entities that issue financial guarantees, the value of the guarantees and the activities they support are significant, e.g. loans to guarantee the debt of state owned entities, PPP projects, etc. The proposed change ensures that all financial guarantees are recognised by an entity on initial recognition rather than some being recognised and some being disclosed. This ensures that all financial guarantees are seen as obligations of government, and are managed accordingly. The proposed measurement requirements ensure that users have information about the credit risk that the issuer is exposed to as a result of guaranteeing another party's debt.
	Loan commitments issued by an entity are recognised and measured, and/or disclosed in accordance with GRAP 19.	Same treatment as for financial guarantee contracts. However, for commitments to provide concessionary loans, the entity recognises the loan commitment at the loss allowance plus any social benefit provided. This amount is recognised in accordance with the *Framework for the Preparation and Presentation of Financial Statements.*	The impact is the same as for financial guarantee contracts. For commitments to provide concessionary loans, the entity will reflect the resources that it commits to provide both in terms of social benefits (to achieve government's objectives), as well as the credit risk the entity is exposed to by granting the loan.	The users will receive information about the potential outflow of economic benefits that the entity commits to provide as a result of entering into an arrangement to provide a concessionary loan. Also see above.

Key differences between existing and proposed requirements of GRAP 104

	Requirement of GRAP 104		Potential impact	Users information needs
	Existing	Proposed		
Classification of financial assets	Financial assets are classified as either being measured at: (a) Amortised cost. (b) Fair value. (c) Cost. The classification of financial assets is based on the definitions below. Reclassifications are not permitted unless the instrument was a combined instrument required to be measured at fair value, or the fair value of an investment in a residual interest is no longer available (or vice versa).	Financial assets are classified as either being measured at: (a) Amortised cost. (b) Fair value. (c) Cost. The classification of financial assets is based on (a) the entity's management model for managing the asset, and (b) the contractual cash flow characteristics of the asset. Reclassifications are permitted when there is a change in the management model for holding the instrument.	Although there is no change in the broad categories in which financial assets are classified, the requirements for when each category are used are different. The classification principles in GRAP 104 are "rules based" as they indicate a classification based on the type of instrument. The proposed classification is principle-based as it focuses on the economic characteristics of the instrument and the reasons for an entity holding an instrument. The classification of simple financial assets such as bank accounts and debtors will be unchanged. For more complex financial assets, for example, investments and concessionary loans, the classification may change.	The new classification principles ensure that the measurement basis used for financial assets reflects the underlying characteristics of the instrument and the reasons why an entity holds an instrument. For example, those instruments that an entity actively sells will be measured at fair value. Fair value is appropriate because it reflects the value an entity would receive for the asset if it had to trade it in a market. Similarly, instruments that reflect a basic lending arrangement, e.g. a loan or bond where the entity aims to collect the capital and interest payments, are measured at amortised cost. Using amortised cost is better than fair value as it reflects the entity's intention to hold the instrument to collect the cash flows. The new classification means that users can make more informed decisions about an entity's performance and how assets are being managed.

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Key differences between existing and proposed requirements of GRAP 104

<table>
<tr><th></th><th colspan="2">Requirement of GRAP 104</th><th rowspan="2">Potential impact</th><th rowspan="2">Users information needs</th></tr>
<tr><th></th><th>Existing</th><th>Proposed</th></tr>
<tr><td>Classification of financial assets</td><td>Amortised cost

The following financial assets are measured at amortised cost:

• Non-derivative instrument with fixed or determinable payments, that are:
• Not held for trading
• Not designated at fair value</td><td>Amortised cost

A financial asset is measured at amortised cost if the:

(a) objective is to hold financial assets to collect contractual cash flows; and
(b) contractual terms of the financial asset give rise, on specified dates, to cash flows that are solely payments of principal and interest on principal (“SPPI”).

Incidental sales of financial assets are permitted in this category. However, the timing, value and frequency of the sales need to be assessed.</td><td>Investments

Previously all investments with fixed or determinable payments would have been classified as instruments at amortised cost. Some investments may not qualify for measurement at amortised cost because of an entity’s management model. If an entity has an active strategy of selling investments (and/or holding and selling investments) that have contractual cash flows that are SPPI, these are measured at fair value and not at amortised cost.

Concessionary loans

All loans would have been classified as financial assets at amortised cost as loans have fixed or determinable payments. Some concessionary loans will no longer be measured at amortised cost because they fail the SPPI criteria. This will most likely be where a loan includes contingent repayment features, and those features are not closely related to a basic lending arrangement. This could be, for example, where repayment of the loan will only occur when an individual becomes employed, earns a certain income, or an entity reaches a specific level of profitability or attains certain ratios.

Where concessionary loans (or other loans) fail the SPPI criteria, they are measured at fair value.</td><td>For the informational value of measuring some investments at fair value see above.

Where an entity issues concessionary loans that have contingent repayment features, using amortised cost does not fully reflect the existence of these features. As a result fair value provides more meaningful information to users on the features of these loans. Additional information is required about any credit losses incurred on these loans, as well as the nominal values of such loans.</td></tr>
</table>

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Key differences between existing and proposed requirements of GRAP 104

	Requirement of GRAP 104		Potential impact	Users information needs
	Existing	**Proposed**		
Classification of financial assets	*Fair value* The following financial assets are measured at fair value: • Derivatives • Combined instruments designated at fair value • Instruments held for trading • Non-derivative instruments with fixed or determinable payments designated at fair value. • Financial assets that do not meet the definition of financial instruments at amortised cost or cost.	*Fair value* A financial asset is measured at fair value through surplus of deficit unless it is measured at amortised cost or cost.	See above.	See above.
	Cost Investments in residual interests of other entities that do not have a quoted price in an active market, and fair value cannot be measured reliably.	*Cost* Investments in residual interests of other entities that do not have a quoted price in an active market, and fair value cannot be measured reliably.	No change.	No change in information available to users.

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Key differences between existing and proposed requirements of GRAP 104

	Requirement of GRAP 104		Potential impact	Users information needs
	Existing	Proposed		
Amortised cost of financial assets	The amortised cost of a financial asset or financial liability is 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 using the effective interest method of any difference between that initial amount and the maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectability.	The proposed requirements make a distinction between the amortised cost of a financial asset and the gross carrying amount of a financial asset. The amortised cost of a financial asset or financial liability is 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 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. The gross carrying amount of a financial asset is the amortised cost of a financial asset, before adjusting for any loss allowance.	The proposed distinction between the amortised cost and gross carrying amount of a financial asset is important when determining interest revenue.	See below.

Key differences between existing and proposed requirements of GRAP 104

	Requirement of GRAP 104		Potential impact	Users information needs
	Existing	**Proposed**		
	Interest revenue is calculated using the gross carrying amount of the financial asset X the effective interest rate.	Interest revenue is calculated as follows: *Financial assets that are not credit impaired* Gross carrying amount of the financial asset X effective interest rate. *Financial assets that have become credit impaired* Amortised cost of the financial asset (i.e. including credit losses) X effective interest rate. *Financial assets that are impaired on purchase or origination* Amortised cost of the financial asset (i.e. including credit losses) X credit-adjusted effective interest rate.	In terms of the existing requirements in GRAP 104, interest revenue was calculated based on the gross carrying amount of the financial asset, using the effective interest rate of the asset. This was the case even when a financial asset was considered impaired. To overcome the potential overstatement of interest revenue and impairment losses, a distinction is made when determining interest revenue on assets that are impaired. The potential impact is that entities will need to ensure that they have appropriate systems in place that cater for the different methods of calculating interest revenue, including the use of different interest rates, i.e. the nominal interest rate, effective interest rate, and credit adjusted effective interest rate. The Board proposes that for receivables, interest revenue on receivables that are credit impaired on purchase or origination need not be calculated using the credit-adjusted effective interest rate. An entity would apply the effective interest rate in determining revenue, but would apply the amortised cost rather than the gross carrying amount if the receivable becomes impaired after origination.	Although the different bases used to calculate interest may add complexity for preparers, this ensures that interest revenue is not overstated on financial assets that are already impaired.

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Key differences between existing and proposed requirements of GRAP 104

<table>
<tr><th rowspan="2"></th><th colspan="2">Requirement of GRAP 104</th><th rowspan="2">Potential impact</th><th rowspan="2">Users information needs</th></tr>
<tr><th>Existing</th><th>Proposed</th></tr>
<tr><td>Impairment of financial assets</td>
<td>An entity assesses at each reporting date whether there is objective evidence that a financial asset measured at amortised cost or cost is impaired.

If any evidence exists, the amount of the impairment loss is calculated as the difference between the asset's carrying amount and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred).</td>
<td>An entity recognises a loss allowance for expected credit losses on a financial asset measured at amortised cost, a lease receivable, a financial guarantee contract or a loan commitment.

An entity measures the loss allowance for a financial instrument at an amount equal to the lifetime expected credit losses if the credit risk of the instrument has increased significantly since initial recognition.

On initial recognition, an entity assesses if an instrument is purchased or originated credit impaired. Any credit losses are included in determining the fair value of the instrument.

Credit losses are measured in a way that reflects:

(a) an unbiased 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 available without undue cost or effort at the reporting date about past events, current conditions, and forecasts of future economic conditions.</td>
<td>Under GRAP 104, an entity would have assessed whether a specific event occurred that indicated that a financial asset is impaired, for example, a debtor entering bankruptcy. This is an "incurred loss model" as it focuses on losses that arise based on the occurrence of a specific event.

The amount of the impairment loss in existing GRAP 104 would have been calculated based on the difference between discounted cash flows that an entity expected to receive based on the event that occurred, and the carrying amount at reporting date.

Under the revised approach, an entity determines impairment losses based on the credit losses an entity expects over 12 months or over the life of the instrument. This is an "expected loss model" as it focuses on both current and future expected losses. Unlike the existing principles in GRAP 104, an entity recognises an impairment loss on day 1.

The proposed approach comprises two steps:

(a) Determine the period over which an entity determines impairment losses, i.e. 12 months or the lifetime of the instrument. The life of the instrument is used where there has been a significant increase in credit risk.

(b) Calculate the probability weighted value of losses based on current and future data.</td>
<td>The financial statements previously only reported losses that were actually incurred. This provided key decision-makers and users of the financial statements little time to take corrective action to avoid any further exposure to credit risk and losses.

Applying the expected credit loss model means that decision-makers and users have information much earlier as the financial statements report losses anticipated by the entity rather than only those that have actually been incurred. This allows better management of credit risk.</td></tr>
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Key differences between existing and proposed requirements of GRAP 104

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<tr><th>Existing</th><th>Proposed</th></tr>
<tr><td></td><td></td><td></td><td>The approach means that an entity needs (a) information about the credit risk of the parties it transacts with, and (b) needs to develop models that assess both current and future losses, on a probability weighted basis.

For receivables and lease receivables, an entity can use the lifetime losses of the instrument, and can use a provision matrix to determine credit loss</td><td></td></tr>
<tr><td rowspan="2">Disclosures</td><td colspan="4">As a result of the change in classification and the introduction of a new impairment model, there have been a number of changes to the disclosure requirements. The most significant change relates to the disclosures related to credit risk. These are outlined below.</td></tr>
<tr><td>An entity discloses by class of financial instrument:

(a) the amount that best represents its maximum exposure to credit risk (usually the carrying amounts of instruments) at the end of the reporting period without taking account of any collateral held or other credit enhancements;

(b) in respect of the amount disclosed in (a), a description of collateral held as security and other credit enhancements;

(c) information about the credit quality of financial assets that are neither past due nor impaired; and

(d) the carrying amount of financial assets that would otherwise be past</td><td>The credit risk disclosures shall enable users of financial statements to understand the effect of credit risk on the amount, timing and uncertainty of future cash flows. To achieve this objective, credit risk disclosures provide:

(a) information about an entity's credit risk management practices and how they relate to the recognition and measurement of expected credit losses, including the methods, assumptions and information used to measure expected credit losses;

(b) quantitative and qualitative information that allows users of financial statements to evaluate the amounts in the financial statements arising from expected credit losses, including changes in the amount of expected credit losses and the reasons for those changes; and</td><td>There are a number of detailed disclosure requirements outlined in the proposed amendments related to the impairment of financial assets. The disclosures are however a reflection of the accounting policies and principles applied to recognise and measure impairment losses. As such, the information should be readily available.

Judgement will need to be applied in deciding the level and extent of the information provided in the financial statements.

Many of these disclosures are unlikely to be relevant to entities with simple financial instruments.</td><td>Although users can expect more detailed information provided in the financial statements, the information is necessary to understand the key principles, bases, assumptions and judgments applied by management to impair financial instruments.</td></tr>
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Key differences between existing and proposed requirements of GRAP 104

	Requirement of GRAP 104		Potential impact	Users information needs
	Existing	Proposed		
	due or impaired whose terms have been renegotiated. Additional disclosures are required for instruments that are part due or impaired.	(c) information about an entity's credit risk exposure (i.e. the credit risk inherent in an entity's financial assets and commitments to extend credit) including significant credit risk concentrations. Specific disclosures are outlined to achieve these objectives.		