FINANCIAL INSTRUMENTS FACT SHEET # 4

CONCESSIONARY LOANS ISSUED	
Definition	A concessionary loan is a loan granted to or received by an entity on terms that are not market related. Concessionary loans are granted by public sector entities to achieve particular policy objectives.
Scope	The loan component of concessionary loans issued by an entity is accounted for as a financial asset. The non-exchange (social benefit) component of arrangement is accounted for using the *Framework for the Preparation and Presentation of Financial Statements.*
Recognition	Recognise loan when entity becomes party to the contractual provisions of the instrument.
Classification	Classification as an instrument at amortised cost or fair value will depend on: (a) The management model for concessionary loans. (b) The characteristics of the cash flows of the loans. Amortised cost - Management model indicates that the entity holds the loan to collect the contractual cash flows, <u>and</u> the cash flows of the loan are solely payments of principal and interest (SPPI). Fair value through surplus or deficit - Management model is not to realise the cash flows by holding the instrument, and/or the cash flows are not solely payments of principal and interest. Measurement at fair value includes a management model where an entity holds financial assets to collect contractual cash and for sale. An entity should consider the existence of any contingent repayment features, e.g. repayment of the loan (and or interest) is only required when certain profitability indices are met, certain level of income demonstrated, an individual finding employment, an entity acquiring certain contracts etc. and whether these affect the classification. An interest free loan will not in itself fail the SPPI requirements.
Initial measurement	*Concessionary loans that are not credit impaired on purchase or origination* Fair value, plus transaction costs if subsequently measured at amortised cost. Fair value = present value of contractual cash flows discounted using a market rate of interest for a similar instrument. A market rate is determined by considering the type of transaction and the counterparty involved. A market rate is the rate for a similar transaction with similar terms adjusted for the credit risk of the counterparty. As a practical expedient, an entity may use the prime lending rate for a group of loans. The rate would however need to be adjusted to reflect any risks specific to those loans. The government bond rate (of the same maturity and risk profile) could be used in determining a market related rate of interest for debts owing by government entities. Difference between transaction price (loan proceeds) and fair value is recognised

	as a social benefit in accordance with the Framework. *Concessionary loans that are credit impaired on purchase or origination* Fair value = present value of contractual cash flows that an entity expects to receive, including expected credit losses, discounted using a market rate of interest for a similar instrument. As there is high degree of judgement involved in determining market rates and consequently fair value, there may be situations where a reliable measure of fair value does not exist. When this is the case, an entity measures a credit impaired concessionary loan by estimating the expected cash flows, including credit losses, and discounting the cash flows using a rate that best represents the time value of money. The difference between transaction price (loan proceeds) and fair value is recognised as a social benefit in accordance with the Framework. The social benefit component includes both the non-exchange element of the loan as well as the expected credit losses.
Subsequent measurement	*Fair value through surplus or deficit* Concessionary loans are measured at each reporting date at fair value. Any gains and losses on remeasurement are recognised in surplus or deficit. *Amortised cost* Concessionary loan are measured at amortised cost, which includes any modification gains and losses, write-offs and impairment losses. Amortised cost is calculated as: Amount initially recognised (fair value plus transaction costs) minus Principal repayments plus or minus Cumulative amortisation* adjusted for Loss allowance *Difference between the initial amount and the maturity amount amortised using the (a) effective interest rate, or (b) credit adjusted effective interest rate (for purchased or originated credit impaired loans).
Loss allowance	A credit loss is the present value of the difference between the contractual cash flows due in terms of the contractual arrangement and the cash flows an entity expects to receive. Step 1: Use lifetime or 12-month expected credit losses Determine if there has been a significant change in credit risk, i.e. change in risk of default occurring, since initial recognition (individual and collective assessment). Significant change in credit risk, including those that are credit impaired on origination, use lifetime expected credit losses. No significant change in credit risk, use 12 month expected credit losses. Rebuttable presumptions (unless reasonable and supportable information to indicate otherwise):

	• Credit risk increased significantly when contractual payments more than 30 days past due. • Default does not occur later than when a financial asset is 90 days past due. <u>Step 2: Measure expected credit losses</u> The expected cash flows are based on the lifetime or 12 month expected credit losses. The contractual period is the maximum period allowed. Expected credit losses are measured so that the following is reflected: • An unbiased and probability-weighted amount is determined by evaluating a range of possible outcomes. An entity must consider the possibility that a credit loss occurs, as well as the possibility that no credit loss occurs. • Time value of money. This is the effective interest rate determined at initial recognition. Expected credit losses are determined based on reasonable and supportable information about past events, current conditions and forecasts of future economic conditions, available without undue cost or effort.
Interest revenue	*Concessionary loan – not credit impaired* Interest revenue = Gross carrying amount of concessionary loan X effective interest rate. *Concessionary loan – becomes credit impaired after recognition (i.e. from beginning of next reporting period)* Interest revenue = Amortised cost* of loan X effective interest rate *includes loss allowance. *Concessionary loan – credit impaired on origination or purchase* Interest revenue = Amortised cost* X credit adjusted effective interest rate. *includes loss allowance.
Derecognition	A concessionary loan is derecognised (in part or in its entirety) when: (a) the contractual cash flows have expired, are settled or waived; (b) the entity transfers to another party substantially all of the risks and rewards of ownership of the financial asset; or (c) the entity has 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.
Presentation and disclosure	An entity considers the presentation and disclosure requirements in GRAP 104 and applies materiality when preparing the financial statements. Specific disclosures are required for concessionary loans issued by entities (see paragraphs 8.24, 8.25, 8.26 and 8.27).