FINANCIAL INSTRUMENTS FACT SHEET #10

INVESTMENTS AND LOANS RECEIVABLE		
Definition	A loan receivable by an entity or an investment made by an entity in another (e.g. purchase of bonds, notice deposits, treasury bills etc.) represents a contractual right to receive cash or another financial instrument. Investments in residual interests are discussed in Fact Sheet #9.	
Scope	Investments (excluding some investments in residual interests) and loans are in the scope of GRAP 104 if they meet the definition of a financial asset.	
Recognition	Recognise investment or loan when entity becomes party to the contractual provisions of the instrument. If the investment is a regular way purchase transaction, trade date accounting should be applied.	Paragraph 3.1
Classification	*Principle* Classification as an instrument at amortised cost or fair value will depend on: (a) The management model for loans and investments. (b) The characteristics of the cash flows of the loans and investments. Amortised cost - Management model indicates that the entity holds the loan or investment to collect the contractual cash flows, <u>and</u> the cash flows of the loan or investment 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 flows and for sale. An entity considers the existence of any features not linked to a basic lending arrangement, most commonly leveraged rates, or repayments linked to a specific activity or threshold, e.g. contingent repayment features where the 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.	Paragraph 4.1-4.4 and AG4.1-AG4.70 [embedded derivatives 4.9-4.15 and AG4.56-AG4.67]
	Interpretation An entity should carefully consider the classification principles of GRAP 104 for subordinated and non-recourse loans. • Where loans are subordinated, the repayment of the loan is based on the receipt of residual net assets after the payment of other creditors rather than the repayment of principal and interest. An entity should consider if the loan is a loan or an investment in the residual interest of another entity. • For non-recourse loans, the underlying collateral of the loan is often a non-financial asset (which could include a business). An entity should consider if the SPPI test is met as at the outset of the loan, it may be the lenders intention to invest in and receive the underlying collateral rather than the interest and/or capital being repaid.	Paragraph AG4.34-AG4.38

This Fact Sheet explains the Secretariat's views on the possible accounting treatment of public sector transactions based on the principles in GRAP 104 on Financial Instruments (revised in 2019). This Fact Sheet accompanies, and is not a replacement for, the complete text of GRAP 104 Financial Instruments. The Fact Sheet outlines the most common features and accounting considerations related to a particular transaction. The accounting may differ depending on the facts and circumstances of individual arrangements. This Fact Sheet has not been reviewed, approved or otherwise acted on by the ASB.

	Financial assets may be reclassified if the management model changes.	Paragraph 4.16-4.17, 5.37-5.41 and AG4.68-AG4.70, AG5.116-AG5.117.
Initial measurement	Fair value, plus transaction costs if subsequently measured at amortised cost. Fair value is the price agreed by a willing buyer and a willing seller in an arm's length transaction. Fair value is determined based on the following: • A quoted price in an active market. • If no active market, using a valuation technique.	Paragraph 5.1 and AG5.1, and AG5.34-AG5.49
	The difference between the transaction price and fair value is recognised as follows: • Surplus or deficit - If fair value evidenced by level 1 inputs or a valuation technique that only uses data from observable markets. • Deferred on the statement of financial position – When any other valuation basis used.	Paragraph 5.2 and AG5.4
Subsequent measurement	<u>Fair value through surplus or deficit</u> Loans and investments are measured at each reporting date at fair value. Any gains and losses on remeasurement are recognised in surplus or deficit.	Paragraph 5.7-5.8, 5.42 and AG5.34-AG5.49
	<u>Amortised cost</u> *Principle* Loans and investments 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 (EIR), or (b) credit adjusted effective interest rate (CAEIR)(for purchased or originated credit impaired loans and investments). EIR (or CAEIR) is not changed unless it is a variable rate loan that resets at specific intervals. *Interpretation* If the loan is received in tranches and it is a fixed rate loan, the original effective interest rate is used or the market rate at each draw down. An entity should develop its own accounting policies for these transactions. If the transaction costs are not material, and the nominal/contractual interest rate is market related, then the nominal/contractual interest rate = EIR	Paragraph 5.13-5.16 and AG5.50-AG5.59

	Gains and losses that arise from the amortisation process are recognised in surplus or deficit.	Paragraph 5.43
Impairment loss (recognised in statement of financial performance)	The amount of expected credit losses (or reversals) that adjusts the loss allowance at reporting date is recognised in surplus or deficit.	Paragraph 5.17-5.29, 5.32-5.35 and AG5.60-AG5.117
Loss allowance (recognised in statement of financial position)	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. <u>Step 1: Use lifetime or 12-month expected credit losses</u> Use of lifetime or 12-month credit losses depends on whether there has been a significant change in credit risk, i.e. change in risk of default occurring, since initial recognition (individual and collective assessment). An entity can assume that there has been no significant change in credit risk if the instrument has low credit risk. Lifetime losses reflect the possible occurrence(s) of default over the lifetime of the instrument. 12-month losses reflect the occurrence(s) of default over the 12-month period from reporting date. 12-month losses are <u>not</u> the lifetime losses apportioned over the 12 month period, <u>nor</u> is it the cash losses that will occur in the next 12-months. 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.	Paragraph 5.17-5.29, 5.32-5.35 and AG5.60-AG5.86
	<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 with the risk of default occurring as the weight. 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 EIR 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. Consider economic conditions of	Paragraph 5.17-5.29, 5.32-5.35 and AG5.87-AG5.115

	borrower as well as general economic conditions.	
Interest revenue	*Loan or investment – not credit impaired* Interest revenue = Gross carrying amount of loan or investment X EIR. *Loan or investment – becomes credit impaired after recognition (i.e. from the beginning of the next reporting period)* Interest revenue = Amortised cost* of loan or investment X EIR. *includes loss allowance. *Loan or investment – credit impaired on origination or purchase* Interest revenue = Amortised cost* X CAEIR. *includes loss allowance.	Paragraph 5.13-5.14
Derecognition	A loan or investment 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.	Paragraph 6.1-6.15 and AG6.1-AG6.14
	If the investment is a regular way sale transaction, trade date accounting should be applied.	Paragraph 3.1
	Gains and losses that arise from the derecognition of a financial asset are recognised in surplus or deficit.	Paragraph 5.43
Presentation and disclosure	An entity considers the presentation and disclosure requirements in GRAP 104 and applies materiality when preparing the financial statements. General disclosures – paragraphs 8.1 and 8.2 Accounting policies – paragraph 8.3 Classes of financial instruments and level of disclosure – paragraph 8.4 Significance of financial instruments to financial position and performance – paragraph 8.5 Statement of financial position – paragraphs 8.6-8.10, 8.21, 8.23. Statement of financial performance – paragraphs 8.30. Notes to the financial statements – 8.31-8.35. Nature and extent of risks arising from financial instruments – paragraphs 8.36 to 8.41, credit risk: 8.42-8.57, market risk (if significant exposure to market risk): paragraphs 8.59-8.60.	Presentation: paragraphs 7.1-7.17 and AG7.1-AG7.8