## FINANCIAL INSTRUMENTS FACT SHEET #2

| BANK ACCOUNTS (ASSETS) | | |
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| **Definition** | Bank accounts held with financial institutions are contractual rights to receive cash. These could include transactional bank accounts, fixed or term deposits, call accounts etc. This Fact Sheet deals with those bank accounts that would be classified as "cash and cash equivalents" in GRAP 2 on *Cash Flow Statements.* | GRAP 2.07-.09. |
| **Scope** | Bank accounts with financial institutions are financial instruments. | Paragraph AG2.1 |
| **Recognition** | Recognise bank accounts when entity becomes party to the contractual provisions of the instrument, e.g. when an entity deposits money with a financial institution. | Paragraph 3.1 and AG3.12-AG3.13 |
| **Classification** | *Principle*<br>An entity considers the following criteria in classifying financial assets.<br>Classification as an instrument at amortised cost or fair value will depend on:<br>(a) The management model for bank accounts, i.e. hold to collect contractual cash flows, or hold for sale.<br>(b) The characteristics of the contractual cash flows of the bank accounts, i.e. whether the cash flows are solely payments of principal and interest (SPPI).<br>*Interpretation*<br>Bank accounts are likely to be classified using amortised cost as:<br>• entities will collect the contractual cash flows (the cash is repaid on demand or based on the notice period or other terms specified); and<br>• the cash flows are solely payments of principal (fair value on initial recognition will be repaid) and interest (based on the terms of the arrangement which are likely to include simple variable or fixed rates consistent with a basic lending arrangement). | Paragraph 4.1-4.4 and AG4.1-AG4.45 |
| **Initial measurement** | Fair value, plus transaction costs if subsequently measured at amortised cost. | Paragraph 5.1 and AG5.2-AG5.11 |
| **Subsequent measurement** | Most bank accounts are likely to be measured at amortised cost, which includes any modification gains and losses, write-offs and impairment losses.<br>*Principle*<br>Amortised cost is calculated as:<br>Amount initially recognised (fair value plus transaction costs)<br>minus Principal repayments<br>plus or minus Cumulative amortisation*<br>adjusted for Loss allowance<br>*Difference between the initial amount and the maturity amount amortised using the effective interest rate (EIR). | Paragraph 5.7, 5.13-5.16, and AG5.50-AG5.59 |

*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.*

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| | *Interpretation*<br>If the transaction costs are not material, and the nominal/contractual interest rate is market related, then the nominal/contractual interest rate = EIR | |
| | Gains and losses that arise from the amortisation process are recognised in surplus or deficit. | Paragraph 5.43 |
| **Impairment loss**<br>**(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-AG5.115 |
| **Loss allowance**<br>**(recognised in statement of financial position)** | The credit losses (loss allowance) represent 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. | Paragraph 5.17-5.29, 5.32-5.35 |
| | Step 1: Use lifetime or 12-month expected credit losses<br>*Principle*<br>The use of lifetime or 12-month expected 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).<br>Significant change in credit risk (including those that are credit impaired on origination) = use lifetime expected credit losses.<br>No significant change in credit risk = use 12 month expected credit losses.<br>*Application*<br>As the bank accounts are short-term in nature, and there are strict legal requirements about the credit risk of the financial institutions with whom public sector entities can transact, it is likely that there is little difference between using lifetime and 12-month expected credit losses. | Paragraph AG5.60-AG5.86 |
| | Step 2: Measure expected credit losses<br>The expected cash flows are based on the lifetime or 12 month expected credit losses. The contractual period is the maximum period allowed.<br>Expected credit losses are measured so that the following is reflected:<br>• An unbiased and probability-weighted amount of credit losses 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.<br>• Time value of money. This is the EIR determined at initial recognition.<br>Expected credit losses are determined based on reasonable and supportable information about past events, current conditions and forecasts of future economic conditions, that is available without undue cost or effort. Consider economic conditions of borrower as well as general economic conditions. | Paragraph AG5.87-AG5.115 |

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| **Interest revenue** | *Bank account – not credit impaired*<br><br>Interest revenue = Gross carrying amount of bank account X EIR.<br><br>*Bank account – becomes credit impaired after recognition (i.e. from beginning of next reporting period)*<br><br>Interest revenue = Amortised cost* of bank account X EIR<br><br>*includes loss allowance.<br><br>Note: The principles for "purchased or originated credit impaired financial assets" have not been illustrated as this is unlikely for a bank account. | Paragraph 5.13-5.14 |
| **Derecognition** | A bank account is derecognised (in part or in its entirety) when:<br><br>(a) the contractual cash flows have expired, are settled or waived;<br><br>(b) the entity transfers to another party substantially all of the risks and rewards of ownership of the financial asset; or<br><br>(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 |
| | Gains or losses on the derecognition of bank accounts (if any) 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.<br><br>General disclosures – paragraphs 8.1 and 8.2<br><br>Accounting policies – paragraph 8.3<br><br>Classes of financial instruments and level of disclosure – paragraph 8.4<br><br>Significance of financial instruments to financial position and performance – paragraph 8.5<br><br>Statement of financial position – paragraphs 8.6, 8.22.<br><br>Statement of financial performance – paragraphs 8.30.<br><br>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 |