FINANCIAL INSTRUMENTS FACT SHEET #3

RECEIVABLES		
Definition	Receivables that are financial assets are contractual rights to receive cash or another financial asset. Receivables arise because credit is extended for the sale of goods, the provision of services or use of assets.	Paragraph AG2.2
	Receivables that <u>do not</u> arise from contracts, i.e. they arise from legislation or similar means, are not financial assets. These receivables, called statutory receivables, are accounted for using the GRAP 108 on *Statutory Receivables.*	Paragraph AG2.11-AG2.13 and 1.3(g)
	Contractual rights to receive goods and services, e.g. prepaid expenses, are not financial assets. These are accounted for using the *Framework for the Preparation and Presentation of Financial Statements.*	Paragraph AG2.9
	Receivables could arise from both exchange and non-exchange transactions within the scope of the Standards of GRAP on *Revenue from Exchange Transactions* (GRAP 9) and *Revenue from Non-exchange Transactions (Taxes and Transfers)*(GRAP 23).	Paragraph 1.8
Scope	Contractual receivables are in the scope of the GRAP 104. For contractual receivables arising from non-exchange transactions, an entity applies GRAP 23 for the initial recognition and initial measurement of those receivables, as well as the applicable disclosure requirements. GRAP 104 is applied for all other aspects (including disclosure).	Paragraph 1.3(f) and (g)
	Lease receivables are subject to the impairment, derecognition, presentation and disclosure requirements of GRAP 104.	Paragraph 1.3(c)(i)
Recognition	Recognise receivables when entity becomes party to the contractual provisions of the instrument, e.g. when an entity provides goods and services on credit.	Paragraph 3.1 and AG3.12-AG3.13
Classification	Classification as an instrument at amortised cost or fair value will depend on the following criteria: (a) The management model for receivables, i.e. hold to collect contractual cash flows, or hold for sale. (b) The characteristics of the contractual cash flows of the receivables, i.e. whether the cash flows are solely payments of principal and interest (SPPI). Amortised cost - Management model indicates that the entity holds the receivable to collect the contractual cash flows, <u>and</u> the SPPI test is met. Fair value through surplus or deficit - The management model is not to realise the cash flows by holding the instrument, and/or the cash flows do not meet the SPPI test. Measurement at fair value includes a management model where an entity holds financial assets to collect contractual cash flows and for sale. It is likely that receivables are measured at amortised cost because (a) entities (generally) hold receivables to collect the cash flows in accordance with the terms of the arrangement, and (b) the characteristics of the cash flows are likely consistent with a basic lending arrangement. An entity should however consider the criteria above. Only amortised cost is illustrated below.	Paragraph 4.1-4.4 and AG4.1-AG4.45 [embedded derivatives: paragraph 4.9-4.15 and AG4.56-AG4.67]

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 when the management model changes.	Paragraph 4.16-4.17, 5.37-5.41 and AG4.68-AG4.70
Initial measurement	Fair value, plus transaction costs if subsequently measured at amortised cost. Fair value usually equals the transaction price (i.e. the consideration to be received). An entity considers if there are any off-market elements that may affect fair value on initial measurement, e.g. goods or services provided interest free for a period of time and/or interest charged is not market related. <u>Interest not charged for initial credit period</u> Short term receivables are not discounted, i.e. separated between revenue and interest if the initial credit period granted is consistent with terms used in the public sector, either through established practice or legislation (e.g. legislation, regulation or by-laws may indicate that a transaction should be settled in X no. of days and that no interest needs to be charged during this time). *Interpretation of IGRAP 1 on Applying the Probability Test on Initial Recognition of Revenue* IGRAP 1.09 and .10 indicate that the full amount of revenue should be recognised at the transaction date. IGRAP 1 deals with the potential non-recognition of revenue as a result of an entity's past history of not collecting or receiving amounts due to the entity as a result of exposure to credit risk (i.e. impairment). When discounting applies, the transaction is still recognised in full and reflected as revenue – it is merely reflected in different line items in the statement of financial performance. There may also be a delay between the initial recognition of the revenue from the sales or goods or services and interest revenue as interest would only accrue subsequently <u>Interest charged not market related over life of instrument</u> In determining whether off-market elements exist, an entity may use a practical expedient. As a practical expedient, an entity may use the prime lending rate for a group of receivables. The rate would however need to be adjusted to reflect any risks specific to those receivables. 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.	Paragraph 5.1-5.3 and AG5.1-AG5.11
Subsequent measurement	*Principle* Most receivables are likely to be 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	Paragraph 5.7 and 5.13-5.16 and AG5.50-AG5.59

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	*Difference between the initial amount and the maturity amount amortised using the effective interest rate (EIR). *Interpretation* 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 (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 5.13-5.29, 5.32-5.35 and AG5.60-AG5.115
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> An entity does not need to test whether it should use lifetime or 12-month expected credit losses. For receivables (including lease receivables), the expected cash flows are based on the *lifetime expected credit losses.* Lifetime losses reflect the possible occurrence(s) of default over the lifetime of the instrument. The contractual period is the maximum period allowed. <u>Step 2: Measure expected credit losses</u> 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 possible 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 borrower as well as general economic conditions. A provision matrix may be used for receivables. Note: The principles for “purchased or originated credit impaired financial assets” are not applied to receivables. This is consistent with the principles in IGRAP 1 where impairment is considered as a subsequent event.	Paragraph 5.13-5.29, 5.32-5.35 and AG5.87-AG5.115
Interest revenue	Interest revenue can be either exchange or non-exchange. Interest revenue = Gross carrying amount of receivable X EIR. *includes loss allowance.	Paragraph 5.13 and 5.31

	Note: The gross carrying amount is used for recognising interest revenue on receivables, irrespective of whether the receivable is credit impaired. The principles for "purchased or originated credit impaired financial assets" are not applied to receivables.	
Derecognition	A receivable 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
	Gains and losses on the derecognition of financial assets 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, 8.12-8.14, 8.21-8.22, 8.23. Statement of financial performance – paragraphs 8.30. 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