FINANCIAL INSTRUMENTS FACT SHEET #6

CONCESSIONARY LOANS RECEIVABLE		
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.	Paragraph 2.1
Scope	The loan component of concessionary loans receivable 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.*	Paragraph 5.4-5.6
Recognition	Recognise loan as a financial asset when entity becomes party to the contractual provisions of the instrument. Consider whether a loan commitment should be recognised prior to the draw-down of cash (see Fact Sheet #8). Where a facility is in place, recognition takes place when the drawn downs occur.	Paragraph 3.1 and AG3.12-AG3.13
Classification	*Principle* 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 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 AG4.41-AG4.45
	Financial assets may be reclassified if the management model changes.	Paragraph 4.16-4.17, 5.37-5.41 and AG4.68-AG4.70
	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	AG4.34-AG4.38

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	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 if 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.	
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 at reporting date. 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.	Paragraph 5.1-5.6 and AG5.1-AG5.7, AG5.12-AG5.17, AG5.20-AG5.24
	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.	Paragraph 5.1-5.6 and AG2.24-AG2.25, AG5.1-AG5.7, AG5.12-AG5.24

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Subsequent measurement	<u>Fair value through surplus or deficit</u> Concessionary loans are measured at each reporting date at fair value.	Paragraph 5.7-5.8, 5.10-5.11 and AG5.34-AG5.49
	Any gains and losses on remeasurement are recognised in surplus or deficit.	Paragraph 5.42
	<u>Amortised cost</u> *Principle* Concessionary loans 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). 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-AG5.115
Loss allowance (recognised in statement of financial position)	A credit loss (loss allowance) 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. Note: the impairment loss excludes the amounts included in the initial determination of fair value.	Paragraph 5.17-5.29, 5.32-5.35 and AG5.60-AG5.115
	<u>Step 1: Use lifetime or 12-month expected credit losses</u> Use of the 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	Paragraph 5.17-5.29, 5.32-5.35 and AG5.60-AG5.86

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	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 is <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.	
	<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 borrower as well as general economic conditions.	Paragraph 5.17-5.35 and AG5.87-AG5.115
Interest revenue	*Concessionary loan – not credit impaired* Interest revenue = Gross carrying amount of concessionary loan X EIR. *Concessionary loan – becomes credit impaired after recognition (i.e. from beginning of next reporting period)* Interest revenue = Amortised cost* of loan X EIR *includes loss allowance. *Concessionary loan – credit impaired on origination or purchase* Interest revenue = Amortised cost* X CAEIR.	Paragraph 5.13 - 5.14

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	*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.	Paragraph 6.1-6.15 and AG6.1-AG6.14
	Gains and losses that arise from the derecognition of a financial asset are recognised in surplus or deficit.	Paragraph 5.42 and 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, 8.25-8.27. 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

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