FINANCIAL INSTRUMENTS FACT SHEET #8

LOAN COMMITMENTS		
Definition	A loan commitment is firm commitment to provide credit under pre-specified terms and conditions.	Paragraph 2.1
Scope	The impairment and derecognition requirements of GRAP 104 apply to all loan commitments issued by an entity. The following loan commitments issued by an entity are subject to all the requirements of GRAP 104: • Those that are designated at fair value through surplus or deficit. • Commitments settled net in cash or by issuing or delivering another financial instrument. • Commitments to provide a loan on below market terms (including concessionary loans).	Paragraph 1.7
Recognition	Recognise loan commitments when an entity becomes party to the contractual provisions of the instrument, e.g. when the loan commitment is issued.	Paragraph 3.1 and AG3.12-AG3.13
Classification	Fair value, with specific measurement after initial recognition.	Paragraph 4.7
Initial measurement	*Loan commitments* Fair value, which is usually equal to the consideration received for issuing the loan commitment. Where no commitment fee is charged, or the fee charged does not represent fair value (i.e. the firm commitment is issued in a non-exchange transaction), an entity measures the loan commitment at fair value. Where no reliable measure of fair value can be determined, an entity measures the loan commitment at the loss allowance.	Paragraph 5.1 and AG5.33
	Commitments to provide concessionary loans Commitments to provide concessionary loans are seen as a sub-set of commitments to provide loans on below market terms, except concessionary loans are provided to achieve specific policy objectives. Where the loan commitment relates to the provision of a concessionary loan, the initial measurement includes both the loss allowance on the loan commitment and the value of any social benefit provided. The effective interest rate on initial recognition is not changed (unless required by GRAP 104) each time there is a draw down on the commitment.	Paragraph AG5.22-AG5.24 and AG5.35-AG5.49
Subsequent measurement	Loan commitments are subsequently measured at the higher of fair value initially recognised less any amortisation of revenue (where applicable) and the loss allowance. Loan commitments to provide concessionary loans that were measured at their loss allowance plus the social benefit component, continue to be measured on this basis for subsequent measurement purposes (Note: only the loss allowance on the loan commitment changes after initial recognition).	Paragraph 4.7 and 5.9

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.

Impairment loss (recognised in statement of financial performance)	The subsequent measurement of loan commitments is the higher of the loss allowance and the initial fair value less accumulated amortisation. Where the loss allowance is higher, an impairment loss is recognised.	
Loss allowance (statement of financial position)	The credit losses (loss allowance) represent the present value of the expected credit losses on the loan or drawdowns on the loan commitment.	Paragraph 5.17-5.29, 5.32-5.36 and AG5.60-AG5.115
	<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 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. Default can be determined for an earlier timeframe – an entity should develop a specific policy in this regard.	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 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. • 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	Paragraph 5.17-5.35 and AG5.87-AG5.115

	conditions, that is available without undue cost or effort. Consider economic conditions of borrower as well as general economic conditions.	
Derecognition	A loan commitment is derecognised when the obligation is discharged, cancelled, expires or is waived. When the terms of the contract are revised, an entity considers whether the existing commitment should be derecognised and a new financial liability recognised. When the terms are revised such that the discounted present value of the cash flows under the new terms are more than 10% different from the discounted present value of the remaining cash flows or the original financial liability, the existing contract is derecognised and a new financial liability recognised. An entity also considers qualitative factors that may affect the ongoing recognition of the instrument, e.g. change in counterparty.	Paragraph 6.16-6.19 and AG6.15-AG6.21
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, 8.23. 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, liquidity risk: paragraph 8.58, market risk (if significant exposure to market risk): paragraphs 8.59-8.60.	Presentation: paragraph 7.1-7.17 and AG7.1 and AG7.8