GRAP 104 on *Financial Instruments* (Revised)

Your guide to understanding and applying the revised Standard

This article is part of a series of articles that discuss the key amendments to GRAP 104 (revised). GRAP 104 is the authoritative source. Other supplementary resources are intended to be read alongside GRAP 104 and do not replace or override its guidance. The article has been prepared by the Secretariat of the ASB for information purposes only. It has not been reviewed, approved, or otherwise acted on by the Board.

Mastering GRAP 104: Investments and loan receivables unpacked

GRAP 104, revised in 2019, provides guidance for accounting for investments and loans receivables, which must meet the definition of a financial asset to fall within its scope. This article outlines essential principles and considerations in accounting for these instruments.

What are investments and loan receivables?

Investments and loan receivables are contractual rights for an entity to receive cash or another financial instrument that arise from a loan receivable or an investment made by an entity (such as the purchase of bonds, notice deposits, treasury bills, etc.).

When should entities recognise investments and loan receivables?

Investments and loan receivables are recognised when an entity becomes a party to the contractual provisions of the instrument. If the investment is a regular way purchase transaction, trade date accounting should be applied.

How should entities classify and measure these instruments?

Financial instruments are **initially measured** at fair value and **subsequently** at amortised cost or fair value through surplus or deficit, based on the entity's management model and the contractual cash flow characteristics.

If the 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 (SPPI), it is classified as *fair value through surplus or deficit*. This includes a management model where an entity holds financial assets to collect contractual cash flows and for sale. If the management model indicates that the entity holds the loan or investment to collect the contractual cash flows, and the cash flows of the loan or investment are SPPI, it is classified as *amortised cost*.

For example, if a municipality lends funds to a local business, the loan is recognised once the contract is signed. The loan is initially measured at fair value, which is usually the transaction price. If the municipality plans to hold the loan to collect contractual cash flows which are solely payments of the principal amount of the loan and the interest, it would be subsequently measured at amortised cost.

Special considerations for classification

Entities must consider whether features of the financial instrument affect its classification.

For example, features such as leveraged rates or repayments linked to specific activities or thresholds may influence classification. Although there is no interest charged in interest-free loans, they do not automatically fail the SPPI requirements. This is because the absence of interest does not, on its own, introduce variability that is inconsistent with a basic lending arrangement.

Impairment and loss allowance

A critical aspect of GRAP 104 (revised) is the recognition of expected credit losses. Entities must assess credit risk and recognise expected losses for investments and loan receivables measured at ***amortised cost***. Entities should use lifetime expected credit losses if there has been a significant increase in credit risk since initial recognition of the instrument. Otherwise, entities should use 12-month expected credit losses.

Continuing from the example above, if the local business has a history of late payments and a current adverse economic environment is expected to continue, the municipality should estimate and recognise expected credit losses on the loan accordingly.

Interest revenue

Interest revenue is recognised using the effective interest method, which calculates the amortised cost of a financial asset and allocates interest income over the relevant period. This method applies only to financial assets that are measured at amortised cost.

How should entities derecognise these instruments?

A financial asset is derecognised when the contractual rights to cash flows from the asset expire, are settled or waived. Derecognition also occurs when substantially all the risks and rewards of ownership are transferred, or control is relinquished.

What are entities required to disclose?

GRAP 104 requires detailed disclosures about the significance of investments and loan receivables, their impact on the entity's financial position and performance, and the associated risks. This ensures stakeholders have a clear understanding of an entity's financial health.

For instance, continuing from the example above, the municipality would need to disclose the carrying amount of the loan, its credit risk, any expected credit losses, and any collateral held.

For additional guidance on investments and loans receivable, refer to this fact sheet. Fact sheets on disclosures are also useful: fact sheet 1of 2 (disclosures financial position and performance) and fact sheet 2 of 2 (disclosures nature and extent of risks).