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.

The classification of financial instruments per GRAP 104 (revised 2019)

Financial instruments are classified on initial recognition for subsequent measurement purposes, based on the underlying characteristics of the instrument and the entity's reason for holding that instrument. GRAP 104 on *Financial Instruments* (revised 2019) requires financial instruments to be classified at amortised cost, fair value or, in exceptional circumstances, financial assets at cost.

Classification of financial assets

The classification of a financial asset at amortised cost or fair value is determined by:

(a) the entity's management model; and

(b) the characteristics of the contractual cash flows of the financial asset.

The management model refers to how an entity manages its financial assets in order to generate cash flows. The entity's management model determines whether cash flows will result from collecting contractual cash flows, selling financial assets or both. In assessing the management model, judgement is applied.

To meet the criteria to apply amortised cost, an entity determines if the characteristics of the contractual cash flows are solely payments of principal and interest (SPPI). Principal is the fair value of the financial asset at initial recognition. Time value for money and credit risk are the most significant elements of interest in a basic lending agreement.

Financial assets are classified at fair value through surplus or deficit when the criteria for amortised cost are not met.

Regardless of the management model and cash flow characteristic assessment, a financial asset may, on initial recognition, irrevocably be classified at fair value through surplus or deficit if doing so eliminates or significantly reduces a measurement or recognition inconsistency or mismatch.

Classification of investments in residual interests

Investments in residual interests are measured at fair value through surplus and deficit, but can be measured at cost in the exceptional circumstances that the fair value cannot be reliably measured. As soon as a reliable measure becomes available, the investment is measured at fair value through surplus or deficit.

Classification of financial liabilities

All financial liabilities are classified and subsequently measured at amortised cost with some exceptions, for example:

- A payable that relates to a financial liability that arises because a financial asset does not qualify for derecognition.
- Financial guarantee contracts.
- Commitments to provide a loan at below-market interest rates.

To understand the transitional arrangements on the classification of financial instruments on adoption of GRAP 104 (2019) you can access the information here. Specific disclosure requirements apply in the first year of adoption to provide users with information on instruments that are reclassified as a result of applying the new requirements.