



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.

Understanding GRAP 104 (revised 2019) – what are bank accounts and how should they be treated?

If there is one financial instrument that all entities have, it is a bank account. Most of an entity's activities are centred around cash in-and-out of the bank. Bank accounts are considered straight forward to account for and, for this reason, often do not get attention when entities prepare their financial statements. A bank account is reflected at the reporting date at the trial balance value, which is reconciled to the bank's statement. What more could there be to them?

While this approach may work most of the time for bank accounts, it is important for an entity to understand and be deliberate in its treatment of bank accounts. For example, can you answer the following questions about your entity's bank account:



- What does GRAP 104 on *Financial Instruments* require?
- How does the entity apply those requirements when accounting for bank accounts (i.e. what is the entity's accounting policy)?
- What information does GRAP 104 and GRAP 2 on *Cash Flow Statements* require to be disclosed in the financial statements?

Classification of bank accounts

GRAP 104 (revised 2019) requires entities to assess their financial instruments against criteria in order to classify instruments. While all financial instruments are initially measured at fair value, the classification determines how an entity would subsequently measure their instruments.

In the simplified accounting approach described above, entities may not identify the importance of deliberately classifying bank accounts and the implications of the classification. This could lead to an incorrect treatment of these instruments, and inappropriate or insufficient information provided in the financial statements.

The classification of a bank account at amortised cost or fair value depends on:

- (a) The management model for bank accounts, i.e. hold to collect contractual cash flows, or hold for sale.
- (b) The characteristics of the contractual cash flows of the bank accounts, i.e. whether the cash flows are solely payments of principal and interest.

Considering this, most bank accounts are likely to be classified at amortised cost, as both of the following statements are likely to be true:

- Entities expect to collect the contractual cash flows rather than to sell the bank account. The cash can be withdrawn (repaid) on demand or based on the notice period or other terms specified.
- The cash flows are solely payments of principal (the fair value on initial recognition will be repaid) and interest (the terms of the arrangement are likely to include simple variable or fixed rates which are consistent with a basic lending arrangement).

Accounting implications of amortised cost

Amortised cost means adjusting the amount initially recognised for any repayments, cumulative amortisation (using the effective interest rate), and any impairment losses and write-offs.

Under most circumstances, the contractual interest rate on a bank account will approximate the effective interest rate and would not require any material adjustments to the instrument. The key change for bank accounts with GRAP 104 (revised) may be determining the loss allowance and whether there are any impairment losses to be recognised by applying the expected credit loss model.

Impairment considerations



The expected credit loss model requires entities to consider their exposure to credit risk, based on the entity's assessment of the counterparty's ability to repay the principal and interest per the contractual terms. Should there be a significant increase in credit risk since initial recognition (think VBS Mutual Bank...), the model requires an assessment of lifetime expected credit losses. Otherwise, the assessment can be done for a 12-month period.

Even though there are strict legal requirements about the credit risk of the financial institutions with whom public sector entities can transact, and financial institutions are themselves highly regulated to ensure their liquidity, entities are required to perform a credit risk assessment at each reporting date.

Disclosures in the financial statements

Information in the financial statements and notes should be specific to an entity's instruments, circumstances and user needs. An entity's classification of its bank account(s) and whether or not they are credit impaired determine a large proportion of the information that should be disclosed in the financial statements.

The requirements of GRAP 104 should be read with GRAP 2 when providing information on bank accounts in the financial statements.

Resources

For more information on how the requirements of GRAP 104 (revised) apply to bank accounts, access a [Fact Sheet on Bank Accounts](#) on the ASB website.