

# IPSAS PROJECT – TRAINING ON SPECIFIC PUBLIC SECTOR ACCOUNTING STANDARDS



Operational Programme II – Cohesion Policy 2007-2013  
*Empowering People for More Jobs and a Better Quality of Life*  
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# Financial Instruments

Training for Maltese Government  
CIPFA, 2015

# Programme

Registration	9:30-10:00
Session 1 <ul style="list-style-type: none"><li>• Introduction</li><li>• Financial Instruments</li><li>• Core Concepts</li></ul>	10:00-12:30
Lunch Break	12:30-13:00
Session 2 <ul style="list-style-type: none"><li>• Core Concepts continued</li><li>• Hedging and Derivatives</li><li>• Contracts with Embedded Derivatives</li></ul>	13:00-15:00
Coffee Break	15:00-15:15
Session 3 <ul style="list-style-type: none"><li>• Disclosures</li><li>• Implementation</li><li>• Summing Up</li></ul>	15:15-17:00

# Introduction

# Accrual Accounting

- method of recording financial transactions where the full characteristics of those transactions are recorded in the period to which they relate.
- all assets owned by the organisation at the end of the period and all liabilities which exist at that point is also recognised in the financial statements.
- records revenues earned and resources consumed in a period rather than simply reflecting the cash movements.

## Benefits of Accrual Accounting

- facilitates better planning, financial management and decision making in government
- a robust and accepted way of measuring the economy, efficiency and effectiveness of public policies.
- allows accurate comparison to be made between different organisations.
- makes reference to the liabilities that an organisation will be required to meet in the future and recognises the benefits that will be obtained from purchased assets over a period of time.

# International Public Sector Accounting Standards

- accrual-based standards used for the preparation of general purpose financial statements by governments and other public sector entities around the world
- a suite of 38 accrual standards have been developed since 1997 along with a cash basis standard for countries moving toward full accrual accounting
- standards draw on International Accounting Standards (private sector based)

# Financial Instrument Standards

- IPSAS 28 – Presentation
- IPSAS 29 – Recognition and Measurement
- IPSAS 30 – Disclosures

<http://www.ifac.org/publications-resources/2014-handbook-international-public-sector-accounting-pronouncements>

# Financial Instruments

## Definitions – Financial Instruments

A Financial Instrument is any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another

## Definitions – Financial Instruments

### Financial Asset

- Cash
- Equity instrument
- Contractual right to receive a financial asset or liability with another
- A contract that may be settled in entity's own equity instruments

Contractual  
right of one  
entity



Another's  
obligation to  
pay

### Financial Liability

- Contractual obligation to deliver cash or other financial asset
- Contractual obligation to exchange financial assets or financial liabilities with another
- A contract that may be settled in the entity's own equity instruments.

## Financial Assets

- Cash and bank deposits
- Accounts Receivable
- Loans Receivable
- Investment Securities
  - Common Shares
  - Fixed Income Investments

# Financial Liabilities

- Accounts payable
- Loans and notes payables
- Bonds
- Taxes payable
- Financial Guarantees

# Derivatives

- Swaps
- Forwards
- Options

## Embedded derivatives

- Debt instruments with embedded swaps
- Debt instruments with embedded options

## Compound financial instruments

The issuer of a non-derivative financial instrument shall evaluate the terms of the financial instrument to determine whether it contains both a liability component and a net assets/equity component. Such components shall be classified separately as financial liabilities, financial assets or equity instruments.

## Contracts to Buy Non-Financial Assets

- Contracts for buying nonfinancial items are not financial instruments unless:
  - The contract permits it to be settled net in cash,
  - The entity has a practice of settling similar contracts net in cash,
  - The entity has a practice of taking delivery and selling the non financial item for a profit,
  - The non-financial item is readily convertible to cash.

## Question 1 - Definitions

A public sector entity that operates a public transit system in a region has entered into a forward contract for the delivery of 50% of its diesel fuel requirements to run its fleet of buses for the next six months to protect itself against projected rising prices.

Is the forward contract a financial instrument? Explain

Would your answer be different if the entity bought and sold future contracts traded on a commodity exchange? Explain

## Question 1 – Definitions

The contract is a derivative instrument because there is no initial net investment, the contract is based on the price of oil, and it is to be settled at a future date. However, if the entity intends to settle the contract by taking delivery and has no history for similar contracts of settling net in cash or of taking delivery of the oil and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin, the contract is not accounted for as a derivative under IPSAS 29. Instead, it is accounted for as an executory contract.

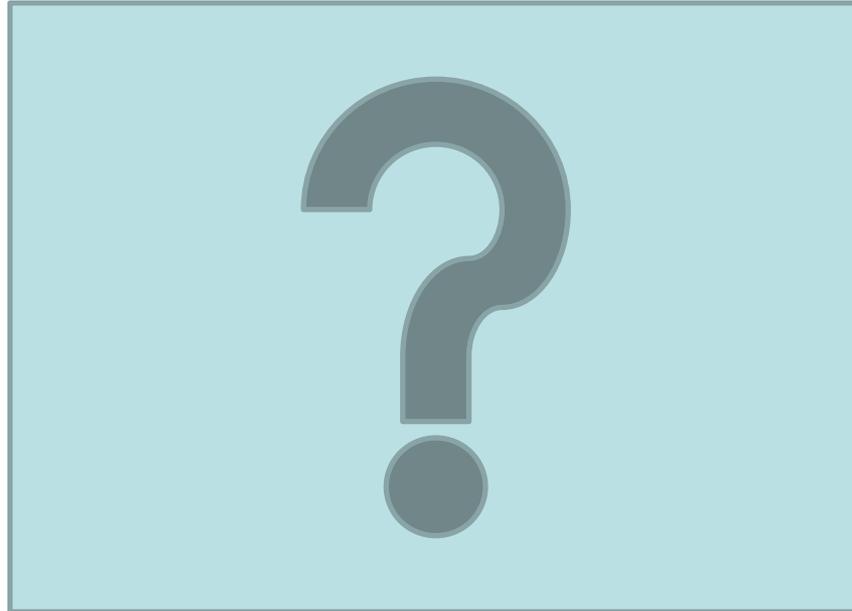
## Question 2 - Definitions

A hospital has entered into a five year lease for a Medical Resonance Imaging scanning machine. The estimated useful life of the machine is 10 years. At the end of the lease term the hospital has the option of acquiring the machine for 10% of its current fair value or extending the lease at a substantially reduced lease payment.

Is the lease a financial instrument? Explain

## Question 2 - Definitions

A finance lease is regarded as primarily an entitlement of the lessor to receive, and an obligation of the lessee to pay, a stream of payments that are substantially the same as blended payments of principal and interest under a loan agreement. a finance lease is regarded as a financial instrument and an operating lease is not

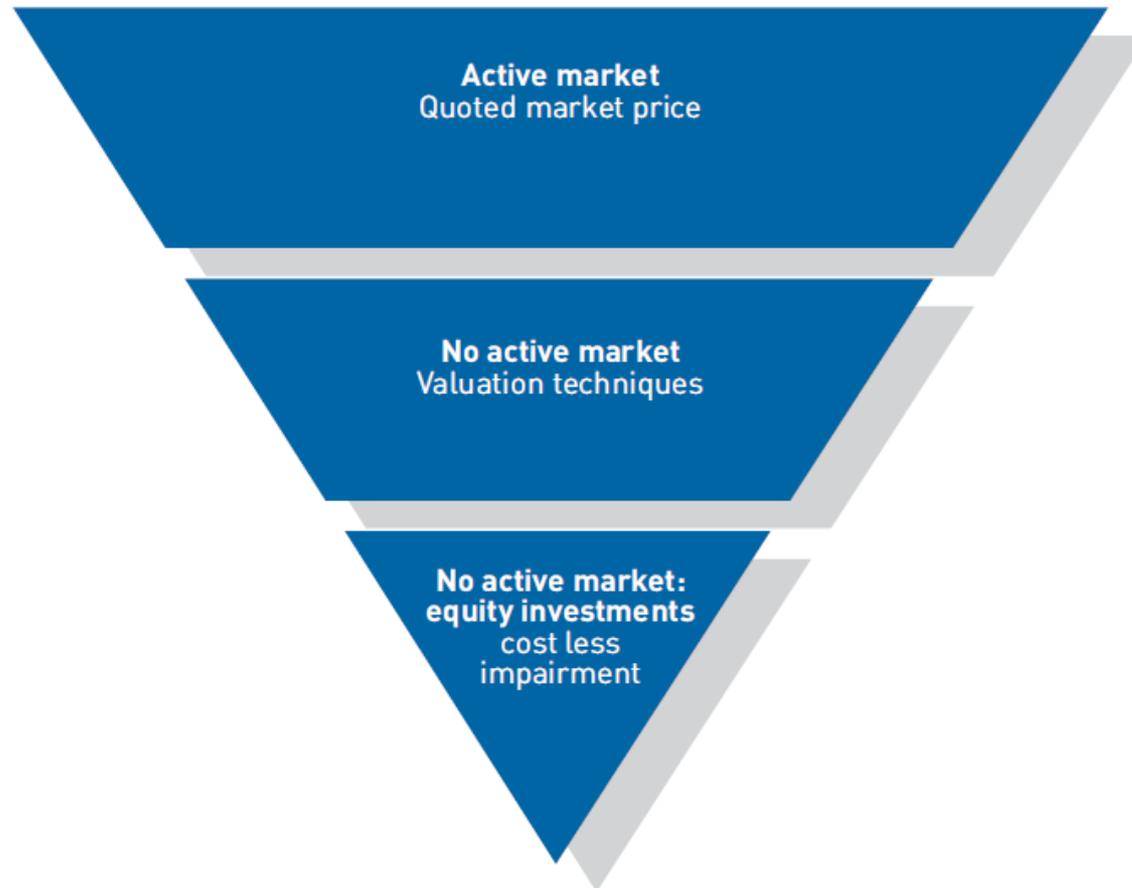


# Core Concepts

## Fair Value

- Incorporates the current market assessment of the future.
- Reflects the collective assumptions and expectations of market participants.
- Changes in fair value reflect the changes in market conditions when they occur.
- Volatility in fair value reflects market volatility.

## Fair Value



## Fair Value

- Active Market – Quoted Market Price.
- No Active Market – Valuation Techniques
  - Recent market transactions
  - Reference to a transaction that is substantially the same
  - Discounted cash flows and option pricing models
- No active market - Equity Instruments
  - If the range of reasonable fair value estimates is significant and no reasonable estimate can be made
  - Cost less impairment.

## Effective Interest Rate

- Reflects in the accounts the true economic substance of a transaction in each reporting period.
- Based on a level yield to maturity
- For 'plain vanilla' fixed and variable rate loans that run to maturity, EIR has no impact.
- But EIR will have implications for
  - Loans with an initial premium or discount
  - Loans with built in options
  - Loans with margins over a benchmark that vary over time
  - Non standard loan structures such as stepped interest rate loans.

## Amortised Cost

Amount at initial recognition

Minus

Principal repayments

Plus/minus

The cumulative amortisation of any difference between initial amount and maturity amount using the effective interest method

Minus

Any reduction for impairment or valuation allowance

## Effective Interest Rate – Example 1

Year	Loan Outstanding 1 April	Interest Rate	Interest Payable	Amortised Cost at 1 April	Effective Interest Rate	Charge to Income and Expenditure	Amortised Cost at 31 March
	a	b	$c = a \times b$	d	e	$f = d \times e$	$g = d + f - c$
2001	1,000,000	3.0%	30,000	1,000,000	4.34%	43,412	1,013,412
2002	1,000,000	3.0%	30,000	1,013,412	4.34%	43,995	1,027,407
2003	1,000,000	3.0%	30,000	1,027,407	4.34%	44,602	1,042,009
2004	1,000,000	3.0%	30,000	1,042,009	4.34%	45,236	1,057,245
2005	1,000,000	3.0%	30,000	1,057,245	4.34%	45,898	1,073,143
2006	1,000,000	6.0%	60,000	1,073,143	4.34%	46,588	1,059,730
2007	1,000,000	6.0%	60,000	1,059,730	4.34%	46,005	1,045,736
2008	1,000,000	6.0%	60,000	1,045,736	4.34%	45,398	1,031,134
2009	1,000,000	6.0%	60,000	1,031,134	4.34%	44,764	1,015,898
2010	1,000,000	6.0%	60,000	1,015,898	4.34%	44,102	0

## Effective Interest Rate – Example 2

The example below shows the impact of the EIR calculation of a five-year bond with a €1m nominal value and a nominal interest rate of 4% purchased for €0.95m

Year	Amortised Cost at 1 April	Effective Interest Rate	Income to I&E	Cash Flows	Amortised Cost at 31 March
1	950,000	5.16%	49,020	40,000	959,020
2	959,020	5.16%	49,485	40,000	968,505
3	968,505	5.16%	49,975	40,000	978,480
4	978,480	5.16%	50,489	40,000	988,969
5	988,969	5.16%	51,031	1,040,000	0

## EIR – no impact

- Short duration receivable or payable with no stated interest rate (measured at original invoice amount)
- Fixed rate instrument when the carrying amount is the same as the redemption amount (no premium, discount or transaction costs reflected in initial carrying amount)
- Variable rate instrument (including inflation linked) with no premium or discount or transaction costs included in the initial carrying amount.

## EIR – watch out for

- Loans where the nominal sum issued or raised is other than at par (e.g. deep discount loans)
- Loans where the initial interest rate or coupon rate is other than at prevailing market rates (e.g. stepped interest)
- Front load interest or interest at maturity

## EIR – caution

- EIR based upon expected life and cashflows of a financial instrument
  - Changes have an impact where there are premium/discount or transaction costs or stepped interest
  - Based upon a group of similar financial instruments.
- Variable rate loans with premium/discount or transaction costs when interest rate changes EIR must be recalculated.

## Recognition and Derecognition

- Recognised when entity becomes a party to the contractual arrangement which is a financial instrument.
- Financial asset derecognised when contractual rights expire, are waived or transferred
  - Cumulative gain or loss recognised in surplus or deficit.
- Financial liability derecognised when contract is discharged, waived, cancelled or expires
  - Difference between the carrying amount and consideration paid recognised in surplus or deficit.

## Trade Date/Settlement Date

- Regular way purchases of financial assets can be recognised at trade date or settlement date (accounting policy choice – but must be consistently applied to group of assets)
- Except for derivatives which are always recognised on trade date.
- Trade date is the date on which an entity commits to purchase or sell an asset.
- Settlement date is the date on which the asset is delivered to, or by, the entity.

## Modification or Extinguishment

- Modification occurs when
  - Old debt is replaced by new debt by means of an exchange of debt instruments between an existing borrower or lender or the terms of an existing liability are modified, and
  - The terms of the loan debt are not substantially different or the modification of the terms of an existing liability is not substantial.
- The exchange must be simultaneous (i.e. on the same day).
- If extinguishment any premium/discount on extinguishment must be charges to surplus/deficit.

## Classification of Financial Assets

- Four categories
  - a) Financial assets at fair value through surplus or deficit
  - b) Held-to-maturity investments
  - c) Loans and receivables
  - d) Available-for-sale financial assets
- Categorisation determines recognition and measurement requirements.

## Financial Assets at Fair Value through Surplus or Deficit

- All financial assets held for trading
- All derivatives (except hedging instruments that meet the accounting definition)
- A financial asset so designated on initial recognition when
  - It eliminates or significantly reduces measurement inconsistency.
  - A group of financial assets, liabilities or both are managed on a fair value basis.

## Held-to-Maturity

- Non derivative financial assets with fixed or determinable payments and fixed maturity that an entity intends to hold to maturity other than:
  - Those designated as at fair value through surplus or deficit
  - Those designated as available for sale
  - Those that are loans and receivables.

## Loans and Receivables

- Non derivative financial assets with fixed or determinable payments that are not quoted in an active market other than:
  - Those that the entity intends to sell
  - Those designated as fair value through surplus or deficit
  - Those designated as available for sale
  - Those not recoverable (classified as available for sale).

## Available-for-sale

- Non-derivative financial assets that are designated as available for sale or are not classified as
  - Financial assets at fair value through surplus or deficit
  - Held-to-maturity investments
  - Loans and receivables

## Classification of Financial Liabilities

- Two main classifications
  - a) A financial liability at fair value through surplus or deficit that is
    1. Financial liability held for trading
    2. Financial liability designated on initial recognition
    3. All derivatives
  - b) A financial liability measured at amortised cost using the effective interest method

## Initial Measurement

- Financial Asset or liability measured at fair value plus transaction costs, except
  - Financial Asset or liability categorised as fair value through surplus or deficit
  - Fair value is normally the transaction price (i.e. the fair value of the consideration given or received)

## Subsequent Measurement – Financial Liabilities

- Measured at amortised cost using the effective interest method except:
  - Financial liabilities classified as fair value through surplus or deficit
  - Derivatives that are liabilities which are measured at fair value
  - Financial liabilities designated as hedge items, which are subject to hedge accounting requirements.

## Subsequent Measurement – Financial Assets

- Financial assets and derivatives are measured at fair value without any deduction for costs of disposal, except
  - Loans and receivables and held-to-maturity are measured at amortised cost using the effective interest method.
  - Investments in equity instruments that do not have a quoted market price are measured at cost.
- Financial assets measured at cost are reviewed for impairment.

## Gains and Losses

- On a financial asset or liability classified at fair value through surplus or deficit in surplus or deficit,
- On an available-for-sale financial asset directly in net assets/equity until the financial asset is derecognised.
  - When derecognised cumulative gain or loss previously recognised in net assets/equity recognised in surplus or deficit.
  - Financial assets and financial liabilities carried at amortised cost recognised through amortisation and on derecognition in surplus or deficit.

## Impairment of Financial Assets - Events

- Significant financial difficulty of the creditor
- Breach of contract, such as default or delinquency in payments
- Granting a concession as a result of the borrowers financial difficulty
- It becoming probable the borrower will enter bankruptcy or other financial reorganisation
- The disappearance of an active market for the financial asset because of financial difficulties
- Observable data indicating that there is a measurable decrease in the estimated future cash flows

## Impairment of Financial Assets

- Financial asset or group of assets assessed each reporting period.
- Losses on financial assets that are loans and receivables or held-to-maturity recognised in surplus or deficit
- Losses on available-for-sale financial assets are recognised in surplus or deficit
- Losses may, under certain circumstances, be reversed in a subsequent period for financial instruments, except for equities.

## Concessionary Loans

- Concessionary loans are granted/received at below market terms.
- A waiver of debt is not a concessionary loan.
- At inception a concessionary loan is recognised as follows:
  - When loan is received by an entity – difference is recognised in accordance with IPSAS23 (Revenue from Non Exchange Transactions)
  - When loan is granted by entity – difference is recognised as an expense in surplus/deficit
- Subsequent measurement is dependant on the classification of the loan (in accordance with IPSAS 29).

## Financial Guarantee Contracts

- Requirement to make specified payments to reimburse the holder of a debt if the debtor fails to make payment when due.
- Initially recognised at fair value
  - Premium received unless evidence otherwise
  - Estimated based on probability of the guarantee being called and likely amount payable
- Subsequently at original amount unless payment becomes probable.

## Question 1 – Core Concepts

Entity A holds 15 percent of the share capital in Entity B. The shares are publicly traded in an active market. The currently quoted price is €100. Daily trading volume is 0.1 percent of outstanding shares. Because Entity A believes that the fair value of the Entity B shares it owns, if sold as a block, is greater than the quoted market price, Entity A obtains several independent estimates of the price it would obtain if it sells its holding. These estimates indicate that Entity A would be able to obtain a price of €105, i.e., a 5 percent premium above the quoted price.

Which figure should Entity A use for measuring its holding at fair value?

## Question 1 – Core Concepts

A published price quotation in an active market is the best estimate of fair value. Therefore, Entity A uses the published price quotation (€100). Entity A cannot depart from the quoted market price solely because independent estimates indicate that Entity A would obtain a higher (or lower) price by selling the holding as a block.

## Question 2 – Core Concepts

Government G entity borrows €50,000 on January 1 20X1 for 5 years. The annual interest rate on the loan is 10% paid at the end of the year. G pays an up-front fee of €1,000 and the net proceeds of the loan are €49,000.

What is the annual effective interest rate of the loan?

What would the annual effective interest rate of the loan be if there is no €1,000 up front fee?

## Question 2 – Core Concepts

$$\text{EIR} = \text{€}5,000 / \text{€}49,000 = 10.2\%$$

With no upfront fee the EIR is 5% and equivalent to the nominal rate.

## Question 3 – Core Concepts

The government makes a €250,000 low interest loan on the following terms:

Capital is repaid as follows:

Year 1 to 2: no capital repayments

Year 3: 30% capital to be repaid

Year 4 30% capital to be repaid

Year 5 40% capital to be repaid.

Interest at 6% interest is paid annually in arrears, the market rate for similar loans is 11.5%

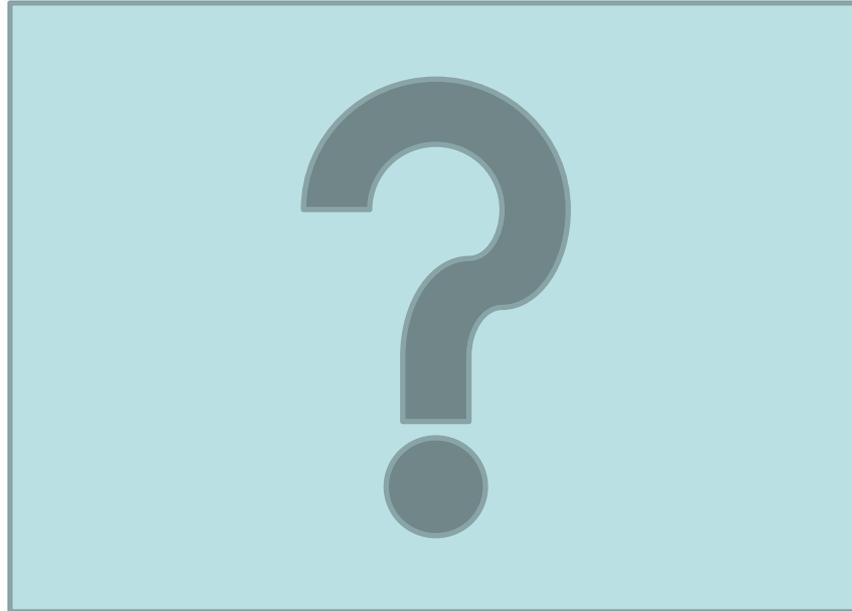
How is fair value determined? Explain

## Question 3 – Core Concepts

The Fair Value is determined by calculating the NPV of the payments using the discount rate of 11.5%

$$= \text{NPV}(11.5\%, 15000, 15000, 90000, 85500, 106,000)$$

$$= 207,270$$



# Hedging and Derivatives

# Derivatives

- A financial instrument when the value is derived from the value of underlying market-based factors
- Essential characteristics
  - Value changes with changes in a specified index (the “underlying”)
  - No or nominal initial net investment required
  - Settled at a future date
- Examples
  - Futures and forwards
  - Swaps
  - Option contracts

## Forward Purchase Contract

- Derivative between trade and settlement date
- On trade date the fair value of derivative will be nil.
- As fair value of underlying asset changes it will have a value.
- Financial asset is recognised at fair value on settlement date
  - Difference between fair value of asset and consideration paid is gain or loss on forward contract derivative
- If open at year end gain or loss is taken to surplus/deficit and shown as asset/liability on the balance sheet.

## Embedded Derivatives

- Is a component of a hybrid instrument, that includes a non-derivative host contract.
- The embedded derivative is not contractually transferrable independent of the host contract.
- Examples include fixed interest rate loans with an option to repay early.
- There is no requirement to account for the embedded derivative separately from the host contract except in specific circumstances.

## Embedded Derivatives

- The embedded derivative should be separated from the host contract and accounted for as a derivative in accordance with the guidance of IPSAS 29, only if
  - The economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract
  - A separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
  - The hybrid (combined) instrument is not measured at fair value with changes in fair value recognized in surplus or deficit

## Embedded Derivatives

- if a contract contains one or more embedded derivatives, an entity may designate the entire contract as a financial asset or financial liability at fair value through surplus or deficit unless:
  - The embedded derivative(s) does not significantly modify the cash flows that otherwise would be required by the contract; or
  - separation of the embedded derivative(s) is prohibited,
- If an entity is unable to measure the embedded derivative separately it shall designate the entire hybrid (combined) contract as at fair value through surplus or deficit.

# Hedge Accounting

- Recognises offsetting effects on surplus and deficit of changes in fair values of hedging instrument and hedged item.
- Hedging instrument is a designated derivative or a non-derivative financial asset or financial liability
- Hedged item is a designated asset, liability, firm commitment or future transaction.
- Designated hedging relationships can be:
  - Fair value hedge
  - Cash flow hedge

## Question 1 – Derivatives

Entity A makes a five-year fixed rate loan to Entity B, while B at the same time makes a five-year variable rate loan for the same amount to A. There are no transfers of principal at inception of the two loans, since A and B have a netting agreement.

Is this a derivative? Explain?

## Question 1 – Derivatives

Yes. This meets the definition of a derivative (that is to say, there is an underlying variable, no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, and future settlement). The contractual effect of the loans is the equivalent of an interest rate swap arrangement with no initial net investment. Non-derivative transactions are aggregated and treated as a derivative when the transactions result, in substance, in a derivative.

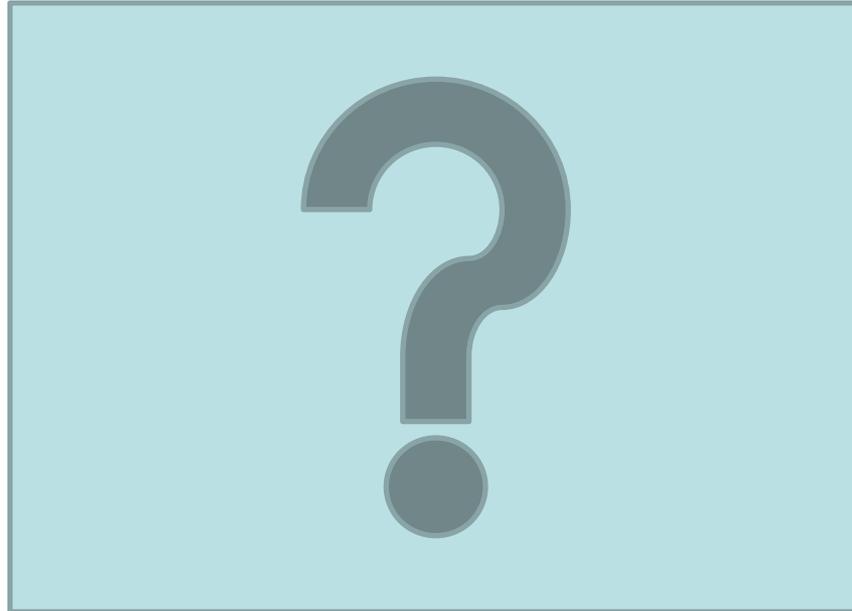
## Question 2 – Derivatives

Entity XYZ enters into a forward contract to purchase one million T ordinary shares in one year. The current market price of T is €50 per share; the one-year forward price of T is €55 per share. XYZ is required to prepay the forward contract at inception with a €50 million payment, equivalent to the current value of the shares.

Is the forward contract a derivative? Explain

## Question 2 – Derivatives

The initial investment in the forward contract of €50 million is less than the notional amount applied to the underlying, one million shares at the forward price of €55 per share, i.e., €55 million. However, the initial net investment approximates the investment that would be required for other types of contracts that would be expected to have a similar response to changes in market factors because T's shares could be purchased at inception for the same price of €50. Accordingly, the prepaid forward contract does not meet the initial net investment criterion of a derivative instrument.



# Disclosures

# Disclosure Requirements

An entity shall disclose information that enables users of its financial statements to evaluate the significance of financial instruments for its financial position and performance.

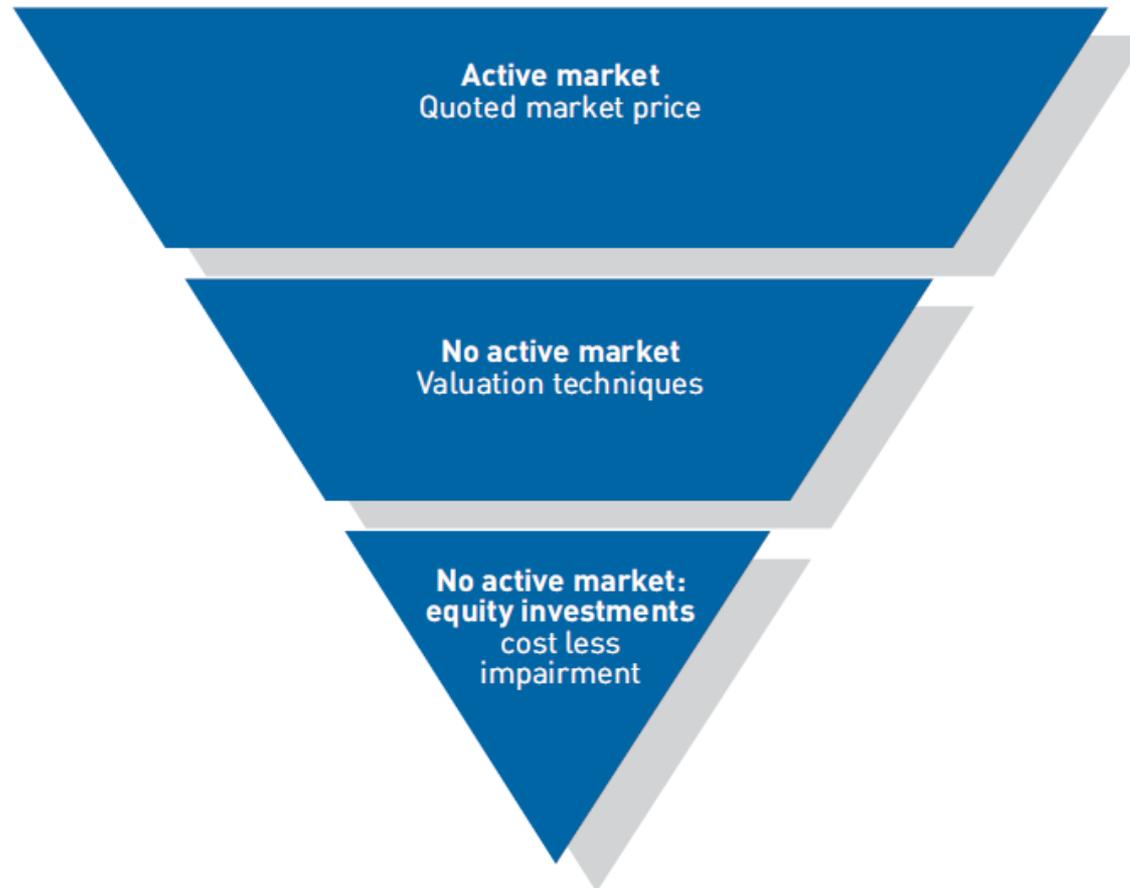
## Disclosure Requirements

- Required items to disclose are as follows:
- Carrying amounts of each category of financial instrument
- Fair value measurements and fair value hierarchy level
- Revenue, expense, gains, or losses
  - Net gains or losses by category
  - Interest revenue and expense
  - Impairment losses
- Information about hedges
- Information about concessionary loans
- Nature, types and extent of risks

## Classes of Financial Instruments

An entity shall group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. An entity shall provide sufficient information to permit reconciliation to the line items presented in the statement of financial position.

## Fair Value



## Disclosure - Risks

<b>Credit risk</b>	<b>the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation</b>
<b>Currency risk</b>	<b>the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates</b>
<b>Interest rate risk</b>	<b>the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.</b>
<b>Liquidity risk</b>	<b>the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset</b>

## Disclosure - Risks

<b>Market risk</b>	<b>the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk, and other price risk</b>
<b>Other price risk</b>	<b>the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market</b>

## Carrying and Fair Value Note - Example

Fair values of liabilities and financial assets are estimates and are generally calculated using market conditions at a specific point in time. The following table presents the carrying amounts and fair values.

	<b>20X2 Carrying Amount</b>	<b>20X2 Fair Value</b>	<b>20X1 Carrying Amount</b>	<b>20X1 Fair Value</b>
Financial Liabilities				
Debt	559,126	597,531	514,020	561,964
Financial Assets				
Loans and Receivables	101,205	124,603	122,147	121,207
Investments	121,771	124,603	99,926	104,925

## Fair Value Hierarchy - Example

The following table shows the fair value hierarchy for fair value measurements of financial assets recognised in the statement of financial position.

	<b>20X2</b> €	<b>Level 1</b> €	<b>Level 2</b> €	<b>Level 3</b> €
<b>Financial Assets at Fair Value through surplus or deficit</b>				
Traded securities	15,650	9,325	4,175	2,150
Derivatives	25,420	10,168	7,827	7,425
<b>Available for Sale Financial Assets</b>				
Equity investments	9,575	925	2,875	5,775
<b>Total</b>	<b>50,645</b>	<b>20,418</b>	<b>14,877</b>	<b>15,350</b>

## Credit Risk - Example

The use of derivatives introduces the credit risk of a counterparty defaulting on contractual obligations. The Province manages its credit risk by dealing only with high credit quality counterparties and entering into contractual agreements that provide for termination netting. The table below presents the gross credit risk for the derivative financial instrument portfolio.

	20X2 €	20X1 €
Gross credit risk exposure	121,771	124,603

# Summing Up and Implementation Issues

## Summary - Accounting for Financial Instruments

### Initial recognition

Financial assets and liabilities will need to be brought on to the Balance Sheet when the authority becomes a party to contractual provisions. This will often be the date that a contract is entered into, but may be later if there are conditions that need to be satisfied.

### Initial measurement

When assets and liabilities are recognised, they also need to be measured at their fair value. The commonest situation will be that the appropriate measure will be the originating transaction (eg the principal amount of a loan or the price paid for buying an investment), but this might not be the case where there have been substantial transaction costs, interest payable or receivable does not reflect market rates or obligations have been taken on under financial guarantees.

## Summary - Accounting for Financial Instruments

Amortisation	Some assets and liabilities will be carried at 'amortised cost', where part of their carrying amount in the Balance Sheet will either be written down or written up via the Surplus or Deficit over the term of the instrument.
Valuation	For the purposes of notes to the accounts, all assets and liabilities will need to be given a fair value, although this will only be recorded in the Balance Sheet for 'available-for-sale' assets. For many instruments fair value will be the same as the outstanding principal amount, but for others there could be a substantial difference (eg an investment in shares).

# Summary - Accounting for Financial Instruments

## Impairment

Financial assets may need to be written down for impairment losses, where it becomes probable that payments due under a contract will not be made.

## Derecognition

Financial assets and liabilities will need to be removed from the Balance Sheet once performance under the contract is complete or the contract is terminated.

There might also be other events in the life cycle of a financial instrument, such as changing underlying market conditions, changes in rates, default, renegotiation, etc that could influence Balance Sheet and Revenue Account treatments.

## Transition to IPSAS for Financial Instruments

Step One	Consider whether to recognise previously derecognised instruments or derecognise previously recognised instruments
Step Two	Classify the financial instruments on the reconstituted balance sheet per the categories of assets and liabilities set out in the standard
Step Three	Identified the assets and liabilities to be measured at Fair Value, Amortised Cost and Cost and account for any necessary re-measurements
Step Four	Assess whether any impairment write-downs or provisions previously made need to be reversed or new write-downs/provisions made
Step Five	Adjust soft loans to fair value
Step Six	Recognise and measure any derivatives and/or embedded derivatives

## Treasury Management benefits

- Requires definition of treasury management objectives and policies.
- Disclosures focus on exposure to key risks and understanding the characteristics of individual financial instruments
- Fair value and EIR may alter the relative merits of different instruments and returns/costs over time
- Hedge accounting forces a discipline around the use of derivatives

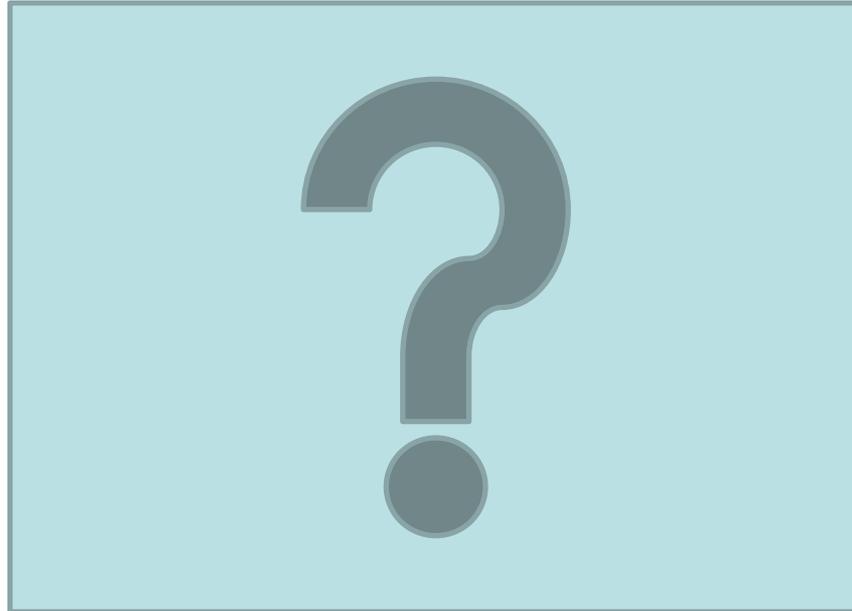
BUT

- Extremely complex and lengthy and accessibility is difficult for the lay user.

# Transition to IPSAS for Financial Instruments

## Practical Issues

- Start early there may be budget issues
  - Effective Interest Rate
  - Impairment
  - Premiums/Discounts
- Not just a Treasury Issue – financial instruments within services
  - Soft Loans
  - Financial Guarantees
  - Embedded Derivatives within contracts
- Communicate widely and frequently



# Thank you

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