



MEMORANDUM

DATE: 12 October 2010

TO: MEMBERS OF THE AUSTRALIAN ACCOUNTING STANDARDS BOARD AND THE FINANCIAL REPORTING STANDARDS BOARD

FROM: JOANNE SCOTT – SENIOR PROJECT MANAGER
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SUBJECT: IPSASs 28-30 Financial Instruments

PURPOSE

1. In developing International Public Sector Accounting Standards (IPSASs) on financial instruments, the International Public Sector Accounting Standards Board (IPSASB) modified the underlying IFRSs and added application guidance on public sector issues. This memo identifies the significant modifications made and application guidance added by the IPSASB and considers whether these modifications and additional guidance should be adopted in Australian and New Zealand financial reporting standards.
2. This memo seeks AASB and FRSB decisions on the recommendations made by staff. In particular,
 - (a) FRSB staff recommend:
 - to insert additional guidance on recognition and measurement of concessionary loans granted and received. This would involve amendments to AASB 139/ NZ IAS 39 *Financial Instruments: Recognition and Measurement* and AASB 9/ NZ IFRS 9 *Financial Instruments*; and
 - to require disclosure of concessionary loans granted. This would involve amendments to AASB 7/ NZ IFRS 7 *Financial Instruments: Disclosures*; and
 - to defer consideration of some issues pending the development of a domestic standard on income from non-exchange transactions;
 - (b) AASB staff concur with the FRSB staff recommendations, except that we would recommend that, if necessary, any additional guidance on concessionary loans and related disclosures be dealt with in the context of the project on income from non-exchange transactions; and
 - (c) both AASB and FRSB staff request the Boards' decisions on whether to issue a joint exposure draft. The draft ED has been prepared based on the FRSB staff recommendations.

BACKGROUND

3. As part of its convergence programme, the IPSASB issued the following standards in January 2010:
 - IPSAS 28 *Financial Instruments: Presentation* – based on IAS 32 *Financial Instruments: Presentation*;
 - IPSAS 29 *Financial Instruments: Recognition and Measurement* – based on IAS 39 *Financial Instruments: Recognition and Measurement*; and
 - IPSAS 30 *Financial Instruments: Disclosures* – based on IFRS 7 *Financial Instruments: Disclosures*.
4. These standards are based on IFRS as at 31 December 2008, together with a small number of amendments made by the IASB in early 2009. The IPSAS has not yet considered IFRS 9 *Financial Instruments*. It plans to do so once the IASB project is complete.

5. In developing IPSASs 28-30 the IPSASB had regard to its "Rules of the Road" and made relatively few public sector specific modifications. Copies of IPSASs 28-30 showing the modifications made by the IPSASB to the underlying IFRS are set out in agenda items B3.4 to B3.6.
6. All three standards are effective for annual periods beginning 1 January 2013. This date was intended to give the IPSASB time to consider whether to develop an IPSAS based on the completed IFRS 9 *Financial Instruments* and if so, what type of public sector modifications would be appropriate in that standard.
7. As noted below, both the AASB and the FRSB have already given some thought to the implications of recent IPSASs for domestic equivalents to IFRSs.

AASB Meeting 4-5 February 2010

8. At its meeting on 4-5 February the AASB considered the differences between IPSASs 28 to 30 and the corresponding IASB standards. Issues considered included accounting for financial guarantee contracts as financial instruments, additional application guidance to deal with concessionary loans and financial guarantee contracts, and additional disclosure requirements on concessionary loans. The AASB decided to jointly discuss the differences and potential amendments to existing Australian Accounting Standards in more detail, in the context of the *Process for Modifying IFRSs for PBE/NFP*, with the FRSB in March 2010.

FRSB Meeting 9 February 2010

9. The FRSB considered its process for adoption or non-adoption of public sector specific modifications in recently released IPSASs. The FRSB agreed that this issue should be discussed jointly with the AASB in March 2010. The FRSB requested that, in developing a draft process for the March meeting that staff consider:
 - the requirements of the IFAC Statement of Membership Obligations, ASRB Release 8 and the *Process for Modifying IFRSs for PBE/NFP* (particularly paragraph 11); and
 - the development of criteria to assist in determining the relative priority of issues.
10. The FRSB considered that all public sector modifications in IPSASs, including those matters not previously covered by NZ IFRSs, should be subject to this process.

Joint AASB/FRSB Meeting 16-17 March 2010

11. The agenda papers for the joint FRSB/AASB March meeting noted relevant requirements governing the two Boards' approaches to public sector and not-for-profit issues. These included:
 - the AASB's *Approach to Public Sector Issues*;
 - the FRSB's Operating Manual;
 - the *Process for Modifying IFRSs for PBE/NFP (the Process)*; and
 - IFAC's Statement of Member Obligations 5.
12. Staff proposed that modifications to IFRSs by the IPSASB should be considered on a case-by-case basis for incorporation into New Zealand and Australian standards.
13. The Boards noted:
 - (a) the staff proposal to consider these modifications now could result in duplication of work as these issues will need to be reconsidered when the IPSASB reviews their financial instrument standards in light of revisions being issued by the IASB;
 - (b) the need to consider costs and benefits – for example, on purely public sector issues, governments may already be looking to IPSASs for guidance and therefore the provisions in an IPSAS need not be incorporated into Australian and New Zealand standards; and
 - (c) the need to determine an approach to modifications based on the Boards' long-term plans in respect of standards issued by the IPSASB.

14. The Boards agreed to address the incorporation of modifications to IFRSs made by the IPSASB jointly and on a case-by-case basis.

FRSB Meeting 26 August 2010

15. The FRSB considered an earlier draft of this memo and provided preliminary feedback on the analysis of issues and the recommendations. The FRSB's views have been incorporated in the analysis of each issue. The impact of the FRSB's feedback was to reduce the number of proposed modifications.

Feedback from Australian Constituents August 2010

16. AASB staff have sought feedback from Australian constituents on certain issues. This feedback has been incorporated in the analysis of issues as appropriate.

APPROACH TAKEN

17. Application of the *Process* (refer agenda item C1) consists of two steps:
- (a) the identification of issues that might warrant modifying an IFRS for PBE/NFP (paragraphs 10-20 of the *Process* discuss factors to be considered in this first step); and
 - (b) consideration of whether those issues are sufficiently significant to warrant departure from an IFRS (paragraph 22 of the *Process* sets out factors to be considered in this step).
18. Paragraph 11 of the *Process* states that a modification to an IFRS in an IPSAS provides supporting evidence that there is a PBE issue that might warrant modifying an IFRS for PBE/NFP. This is subject to understanding the original rationale of the IASB and the reason why the modification was made by the IPSASB.
19. Paragraph 22 of the *Process* is set out below.

Extract from the *Process*

22. The FRSB and AASB will take the following into account when deciding whether or not the identified PBE/NFP issue is so significant that a modification to an IFRS is warranted:
- (a) an estimate of the significance of any modification on the financial statements;
 - (b) an estimate of the significance of a transaction, event or circumstance on the financial statements taken as a whole;
 - (c) whether or not a modification will increase or decrease internal consistency within IFRSs as modified for PBE/NFP; and
 - (d) the costs of preparing the modification and the costs of requiring preparers, auditors and users to learn and apply two sets of requirements.

20. The approach taken in this memo is as follows:
- **to identify modifications in IPSASs 28-30.** These modifications are set out in agenda items B3.4 to B3.6 and are summarised in this memo. The existence of modifications in IPSASs 28-30 is taken as supporting evidence that a PBE/NFP issue exists. In this memo staff has considered only those modifications that are considered to be significant;
 - **to consider why the modifications were made by the IPSASB** (as per paragraph 11 of the *Process*). Some of the IPSASB's reasons for modifications are noted in agenda items B3.4 to B3.6; and
 - **to recommend whether a modification to an IFRS is warranted.** Recommendations are based on an analysis of the factors set out in paragraphs 10-20 and 22 of the *Process* and other matters that staff considers to be relevant.
21. Staff initially experienced difficulty in making consistent recommendations. In a number of cases staff agreed with the IPSASB's rationale for making modifications but did not consider that an amendment to an AIFRS or NZ IFRS would change current practice (and could

therefore be regarded as unnecessary). The impact, or lack of impact, of a NFP/PBE modification on current practice is not explicitly identified by the *Process*.

22. Discussion at the FRSB August 2010 meeting suggested that the number of affected entities and impact on current practice could influence the assessment of the significance of an issue.

IPSAS 28 *Financial Instruments: Presentation*

23. This section of the memo discusses the significant public sector modifications to the requirements of IAS 32 made by IPSASB in developing IPSAS 28. The modifications are summarised in the following table: the actual modifications are illustrated in agenda item B3.4. This memo does not recommend incorporating any of the IPSASB's modifications in AASB 132/ NZ IAS 32 *Financial Instruments: Presentation*.

IPSAS 28	AASB132/NZ IAS 32	Recommendation/Comment
<p>Scope – Financial guarantee contracts Permits financial guarantee contracts to be accounted for as insurance contracts so long as the issuer elects to do so and uses accounting applicable to insurance contracts (paragraphs 3 and AG5-9). Does not require an explicit assertion that the financial guarantees are insurance contracts.</p>	Permits financial guarantee contracts to be accounted for as insurance contracts so long as the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts (paragraph 4).	No change. The issue is also being considered in the context of the IASB ED/2010/8 <i>Insurance Contracts</i> , which proposes that all financial guarantees be treated as insurance contracts.
<p>Financial guarantees – contractual or non-contractual? Includes additional Application Guidance to identify when financial guarantees are contractual (paragraphs AG3-AG4).</p>		No change.
<p>Contractual arrangements Includes additional Application Guidance explaining the factors an entity should consider in assessing whether an arrangement is contractual or non-contractual (paragraphs AG19-AG24).</p>		No change.
<p>Unissued currency Provides clarification that unissued currency is not a financial instrument and that IPSAS 12 <i>Inventories</i> applies to unissued currency (paragraph AG10).</p>	No equivalent guidance in AASB 132 or NZ IAS 32. NZ IAS 2 <i>Inventories</i> states that inventories held by PBEs may include stocks of unissued currency (paragraph NZ 8.1). AASB 102 <i>Inventories</i> does not include such guidance.	No change. The difference between NZ IAS 2 and AASB 102 can be considered in the context of Australia/New Zealand convergence.
<p>Equity instruments Includes additional Application Guidance that: (i) explains the use of equity instruments in the public sector; (ii) acknowledges the different forms of capital that exist in the public sector; (iii) clarifies that "equity instruments" refers to all instruments that evidence</p>	AASB Interpretation 1038 <i>Contributions by Owners Made to Wholly-Owned Public Sector Entities</i> provides guidance on identifying contributions that are equity in nature.	No change. AASB Interpretation 1038 can be considered in the context of Australia/New Zealand convergence.

IPSAS 28	AASB132/NZ IAS 32	Recommendation/Comment
a residual interest in the net assets of an entity, including some liabilities. (paragraphs 25-27)		

IPSAS 28 Scope (paragraphs 3 and AG5-9)

Modification

24. IPSAS 28 permits financial guarantee contracts to be accounted for as insurance contracts so long as the issuer elects to do so and uses accounting applicable to insurance contracts (paragraphs 3 and AG5-9). IPSAS 28 allows an entity to make this election on a contract by contract basis at the time of adoption, and does not require any explicit assertions prior to this election. A similar scope modification has been made in each of IPSASB's financial instrument standards.
25. The election to treat financial guarantee contracts as financial instruments or insurance contracts under IAS 32 and IFRS 4 *Insurance Contracts* is available only to those entities that previously explicitly asserted that they deem such contracts to be insurance contracts. The IASB's deliberations regarding the treatment of financial guarantee contracts (and which standard they fall under) are set out in IAS 39, paragraphs BC21-BC23E. Mindful of the need to develop a 'stable platform' of Standards for 2005, the Board finalised IFRS 4 in early 2004 without specifying the accounting for financial guarantee contracts and then published an Exposure Draft *Financial Guarantee Contracts and Credit Insurance* in July 2004. The financial guarantee scope exemptions in IAS 32 and IAS 39 were regarded as temporary solutions to balance the competing concerns raised by insurers (that there were important economic differences between credit insurance contracts and other forms of financial guarantee contracts) and the IASB (that some issuers of financial guarantee contracts might argue that no recognisable liability existed at inception). Although some submissions to the IPSASB during the development of IPSAS 28 and IPSAS 29 highlighted the limited nature of the financial guarantee scope exemptions in IAS 32 and IAS 39, the IPSASB chose to provide a broader exemption.

IPSASB's rationale regarding scope

26. The IPSASB considered that the requirements in IFRS 4 regarding previous explicit assertions were too onerous.

Application of the Process

27. Staff considers that it is not appropriate to apply the *Process* to this issue. PBE/NFP will have already determined their treatment of financial guarantee contracts on adoption of AIFRSs or NZ IFRSs. Adoption of the broader exemption in IPSAS 28 would have very little impact in Australia and New Zealand. Furthermore, the issue will be re-deliberated in the context of ED/2010/8 *Insurance Contracts*.

Recommendation

28. It is recommended that the Boards
- agree not to amend the scope of AASB 132 or NZ IAS 32 in respect of financial guarantee contracts; and
 - note that similar scope modifications have been made in IPSAS 29 and IPSAS 30; and
 - agree not to amend the scopes of AASB 139/NZ IAS 39 and AASB 7/NZ IFRS 7 in respect of financial guarantee contracts.
29. *Do the Boards agree?*

IPSAS 28 Financial guarantees – contractual or non-contractual? (paragraphs AG3-AG4)

Modification

30. IPSAS 28 (paragraphs AG3-AG4) includes additional guidance on financial guarantee contracts. The additional guidance:
- distinguishes between rights to issue guarantees (non-contractual) and the actual issue of guarantees (which may be either contractual or non-contractual);
 - provides two examples of contractual financial guarantees (including a guarantee in respect of holders of an identified instrument rather than specific counterparties); and
 - refers entities to the guidance in paragraph AG20 (discussed in the next section of this memo) to determine whether a financial guarantee is contractual.

IPSASB's rationale for paragraphs AG3-AG4

31. The IPSASB's reasons for inserting application guidance on the identification of financial guarantee contracts is set out in IPSAS 28 paragraph BC14.

BC14. Financial instruments in IPSAS 28 are defined as: "...any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity." As arrangements in the public sector may arise through statutory powers, the IPSASB developed additional application guidance to identify when financial guarantees are contractual. The IPSASB concluded that, to be within the scope of IPSAS 28, financial guarantees should have the key features of a contractual arrangement. The IPSASB also concluded that an entity should distinguish the right to issue guarantees, which is often conferred on an entity through statutory or similar means, and the actual issuing of the guarantee in favour of a third party, irrespective of whether that party is explicitly or implicitly identified. A statutory right to issue guarantees, of itself, is not within the scope of this Standard.

IPSAS 28 paragraph BC14

Application of the Process

Prevalence and uniqueness

32. The issues identified by the IPSASB that led to the inclusion of paragraphs AG3-4 are likely to be present at a whole of government level in Australia and New Zealand. Central, state and local governments may issue a wide range of guarantees (including guarantees for deposits in financial institutions). Although many of these guarantees may be clearly assessed as being contractual, there may be situations where classification is more difficult. Individual public sector entities are less likely to encounter this issue as they are often prohibited from entering into guarantees or may so do only in limited circumstances.
33. The need to decide whether a financial guarantee should be accounted for under IAS 32/ IAS 39 or another standard is not unique to public sector entities. Private sector entities (both NFP and profit-oriented) may also encounter this issue, although less frequently.

Impact on current practice

34. Staff considers that paragraphs AG3-AG4 would not be expected, on their own, to lead to any change in current practice by PBE/NFP in Australia and New Zealand. Comments supporting this view are as follows:
- The guidance on the distinction between rights to issue guarantees and the actual issue of guarantees would mainly be relevant for public sector entities with rights to issue guarantees under legislation. In Australia and New Zealand most public sector entities have been applying AIFRSs and NZ IFRSs for a number of years and are required to have their financial statements audited. If the existence of statutory rights to issue guarantees created confusion one would have expected the issue to have been raised with the AASB or FRSB before now.
 - The two financial guarantee examples in IPSAS 28 paragraph AG4 appear to be consistent with the explanation of the terms "contracts" and "contractual" in IAS 39, paragraph 13. Concerns about whether additional guidance in IPSAS 28 modifies the meaning of a contract in IAS 32 are discussed in relation to IPSAS 28 paragraphs AG19-AG20 in the next section of this memo.
 - The two examples also appear to be consistent with the definition of a financial guarantee contract in IAS 39 paragraph 9. IAS 39 defines a financial guarantee contract

as " a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a *specified debtor* fails to make payment when due in accordance with the original or modified terms of a debt instrument". Although IAS 39 refers to a "specified debtor" it does not require that a named individual or entity be identified.

- The classification of financial guarantees as contractual or non-contractual may have little impact on how the guarantee is accounted for (see discussion in subsequent paragraphs).
35. IAS 39 paragraph 47(c) requires financial guarantee contracts to be subsequently measured at the higher of (a) the amount determined in accordance with IAS 37, and (b) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue*. IAS 39 also allows for the possibility of financial guarantee contracts being measured in accordance with paragraph 47(a)¹ or 47(b)². Staff considers that few PBE/NFP are likely to account for financial guarantee contracts in accordance with paragraph 47(a) or 47(b).
36. Entities accounting for non-contractual financial guarantees would develop their accounting policies in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, particularly the requirement to consider the requirements in IFRSs dealing with similar and related issues. Relevant standards could include AASB 139/NZ IAS 39, AASB 137/ NZ IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and AASB 4/ NZ IFRS 4 *Insurance Contracts*.
37. Staff views on the application of the factors outlined in the *Process*, paragraph 22, to the additional guidance in IPSAS 28 paragraphs AG3-AG4 are set out in the following table.

Process (paragraph 22)	Comment
(a) an estimate of the significance of any modification on the financial statements	Little or no impact on recognition or measurement. The terms "contract" and "contractual" in IAS 32 and the term "financial guarantee contract" in IAS 39 are quite broad. Some non-contractual financial guarantees may already be accounted for in accordance with IAS 39.
(b) an estimate of the significance of a transaction, event or circumstance on the financial statements taken as a whole	Significance will vary across types of entities. More likely to be significant for federal/state/central governments.
(c) whether or not a modification will increase or decrease internal consistency within IFRSs as modified for PBE/NFP	No impact.
(d) the costs of preparing the modification and the costs of requiring preparers, auditors and users to learn and apply two sets of requirements	Limited costs to prepare modification – based on IPSAS 28 requirement. Limited impact on preparers etc as not expected to lead to a change in current practice.

¹ Financial liabilities at fair value through profit or loss.

² Financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies.

Recommendation

38. It is recommended that the Boards:
- agree not to insert additional guidance, based on IPSAS 28 paragraphs AG3-AG4, on identifying when financial guarantees are contractual, in AASB 132 and NZ IAS 32.
39. *Do the Boards agree?*

IPSAS 28 Contractual arrangements (paragraphs AG19-AG24)

Modification

40. All of the additional guidance in IPSAS 28 paragraphs AG19-AG24 could be regarded as an expansion of IAS 32 paragraph AG12 which commences with the sentence "Liabilities or assets that are not contractual (such as income taxes that are created as a result of statutory requirements imposed by governments) are not financial liabilities or financial assets."
41. There are three parts to this section of additional Application Guidance in IPSAS 28.
- Paragraphs AG19-AG20 explain the features an entity should consider in assessing whether an arrangement is contractual or non-contractual. The three features identified in IPSAS 28 are willing parties, rights and obligations, and enforceability. The additional guidance focuses on substance over form. There is no equivalent guidance in AASB 132 or NZ IAS 32 but the concept of substance over form is consistent with the IASB *Framework*. The IASB *Framework* states 'If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form'.
 - Paragraphs AG21-AG22 note that non-exchange revenue transactions may be contractual or non-contractual. IPSAS 28 states that if such transactions are contractual, an entity must decide if the assets or liabilities arising from the transaction fall within the scope of IPSAS 28. It also requires that entities consider the requirements of IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)* and IPSAS 28 in determining whether a transaction gives rise to a liability or an equity instrument. There is no equivalent guidance in AASB 132 or NZ IAS 32 and there is currently no equivalent to IPSAS 23 in IFRSs as adopted in Australia and New Zealand.
 - Paragraphs AG23-AG24 clarify that a number of other obligations fall outside the scope of IPSAS 28. Part of this guidance is based on IAS 32 paragraph AG12.

IPSASB's rationale for paragraphs AG19-AG24

42. The rationale for these paragraphs is not clearly identified in the Basis for Conclusions. The main purpose is to help entities decide whether certain assets and liabilities fall within the scope of IPSAS 28 or another standard. In relation to the three subsets of guidance, the following rationale can be inferred:
- some public sector entities are prohibited from entering into legal contracts and may have difficulty in deciding which standard to apply;
 - many public sector entities will have assets and liabilities arising from non-exchange revenue transactions, and in the absence of further guidance, might have difficulty in deciding which standard to apply; and
 - the guidance highlights that statutory obligations and constructive obligations fall outside the scope of IPSAS 28.

Application of the Process – General

43. Staff considers that most PBE/NFP would not require the additional guidance in IPSAS 28 (paragraphs AG19-AG24). The arguments put forward in support of this view are:
- unlike public sector entities in some jurisdictions, public sector entities in Australia and New Zealand generally have the power to enter into contracts (although limitations on the incurrence of liabilities and issuing of guarantees are common); and
 - governments, individual public sector entities and some larger private sector NFP have been applying financial reporting standards similar to IFRSs for a number of years. The application of such financial reporting standards encourages clear arrangements.

Application of the Process – paragraphs AG19-AG20

44. Paragraphs AG19-AG20 explain the features an entity should consider in assessing whether an arrangement is contractual or non-contractual. The three features identified in IPSAS 28 paragraph AG20 are willing parties, the creation of rights and obligations, and enforceability (see below). In considering this guidance at its August 2010 meeting the FRSB queried whether the additional guidance in IPSAS 28 modifies the meaning of a contract in IAS 32 and IAS 39 or merely interprets the IFRSs definition. FRSB members did not form a unanimous view on this issue.

AG20. Contractual arrangements, for the purposes of this Standard, are generally evidenced by the following (although this may differ from jurisdiction to jurisdiction):

- Contractual arrangements typically involve willing parties entering into an arrangement. This means that arrangements that compel parties to transact with one another, such as when a government levies taxes on its citizens, are non-contractual in nature.
- The terms of the contract create rights and obligations for the parties to the contract, and those rights and obligations need not result in equal performance by each party. For example, a donor funding arrangement creates an obligation for the donor to transfer resources to the recipient in terms of the agreement concluded, and establishes the right of the recipient to receive those resources. These types of arrangements may be contractual even though the recipient did not provide equal consideration in return i.e. the arrangement does not result in equal performance by the parties; and
- The contract is enforceable by law.

IPSAS 28 paragraph AG20

45. Paragraph 13 of IAS 32 is shown below.

13 In this Standard, 'contract' and 'contractual' refer to an agreement between two or more parties that has clear economic consequences that the parties have little, if any, discretion to avoid, usually because the agreement is enforceable by law. Contracts, and thus financial instruments, may take a variety of forms and need not be in writing.

IAS 32 paragraph 13

46. Does IPSAS 28 paragraph AG20 extend the definition of a contract in IAS 32?

- The first bullet point of paragraph AG20 states that contractual arrangements *typically* involve willing parties. IAS 32 and IAS 39 do not refer to willing parties although the use of the word "agreement" implies this.
- The second bullet point of paragraph AG20 discusses the creation of rights and obligations and makes the point that they may not result in equal performance by each party. IAS 32 and IAS 39 do not specifically address this point. However, it could be argued that the uncertainty associated with items such financial guarantees demonstrates that IAS 32 and IAS 39 apply to items where there may not be equal performance by each party.
- Enforceability is addressed by IAS 32 paragraph 13.

47. Staff considers that the guidance in IPSAS 28 paragraph AG20 is not necessarily inconsistent with the definition of a contract in IAS 32, but does expand upon that definition.

Statutory receivables

48. Staff has also considered whether paragraphs AG19-AG20 would assist in the classification of statutory receivables as financial or non-financial assets.

49. IAS 32 paragraph AG12 states that "Liabilities or assets that are not contractual (such as income taxes) that are created as a result of statutory requirements imposed by governments are not financial liabilities or financial assets. Accounting for income taxes is dealt with in IAS 12." This statement on its own does not assist with the classification of sovereign receivables as IAS 12 *Income Taxes* deals with deferred tax assets and liabilities of taxpaying entities, not tax receivables of governments. In adopting IAS 32 neither the AASB nor the FRSB made any changes to IAS 32 paragraph AG12. Some would argue that this implied that the Boards considered that tax receivables are not financial assets. Others would argue that

IFRSs as adopted in Australia and New Zealand do not address the classification of income taxes receivable by government.

50. In preparing financial statements for the Government of New Zealand the New Zealand Treasury has taken the view that sovereign receivables are not financial instruments (Treasury, *Reporting Tax Receivables under NZ IFRS*, April 2008). In the interests of transparency the New Zealand Treasury did apply the disclosure requirements of NZ IFRS 7 *Financial Instruments: Disclosure* to sovereign receivables in the Government's 2008 financial statements. On review it decided that the disclosures did not add any value and were not useful. Currently the New Zealand Government's sovereign receivables are initially recognised at the amount estimated to be owed by the taxpayer and subsequently adjusted for interest and penalties and reassessed annually for impairment (under NZ IAS 36 *Impairment of Assets*).
51. In response to a request by the Australasian Council of Auditors-General (ACAG), the AASB considered the treatment of statutory receivables³ at its December 2009 meeting. Based on an analysis of comments from Australian jurisdictions and the New Zealand Treasury, AASB staff noted the following:⁴
- (a) Within Australia, all jurisdictions have broadly similar types of statutory charges that may give rise to statutory receivables, which are considered material at Whole of Government, General Government Sector and some individual entity levels;
 - (b) The current approaches adopted by Australian jurisdictions and the New Zealand Government are inconsistent and there is no approach that is dominant. Specifically, practice in Australia is split between the application of AASB 136 (Australian, New South Wales and Victorian governments [and the New Zealand Government adopts NZ IAS 36 for tax receivables]) and AASB 139 (Western Australian, South Australian, Queensland, Tasmanian and North Territory governments); and
 - (c) There is no clear majority view on which Standard should apply. More jurisdictions express a preference for AASB 139; however, three jurisdictions argue strongly that it would be more appropriate to apply AASB 136/ NZ IAS 36.
52. The AASB expressed the preliminary view that the impairment requirements in AASB 136 apply to non-contractual assets. This view relied on paragraph AG12 of AASB 132. The AASB noted that, in accounting for the impairment of non-contractual assets, professional judgement needs to be applied, including in relation to assessing materiality and using estimates, averages and computational short cuts referred to in paragraph 23 of AASB 136. The AASB Chairman has written to the ACAG, with a copy to the HoTARAC, conveying the Board's preliminary view. The AASB also decided that given the guidance as to what constitutes a financial instrument in AASB 132 *Financial Instruments: Presentation*, neither an Aus paragraph in AASB 132 or AASB 136, nor a formal Board Agenda Decision explicitly addressing the impairment of statutory receivables is warranted.
53. The FRSB discussed IPSAS 28 paragraphs AG19-20 at its meeting in August 2010. The FRSB noted that:
- the inclusion of guidance based on IPSAS 28 paragraphs AG19-20 would not change the New Zealand Government's accounting policy for statutory receivables;
 - the AASB has previously considered the treatment of statutory receivables and, at this stage, is not proposing to pursue this issue.

Application of the Process – paragraphs AG20-AG21

54. The IPSASB considered whether non-exchange revenue transactions can give rise to financial assets and financial liabilities. The IPSASB concluded that:
- assets arising from non-exchange transactions could be financial assets (IPSAS 28 paragraph BC19); and

³ This term referred to all receivables related to statutory charges, such as income tax, payroll tax, land tax, council rates, parking fines, traffic infringements and stamp duty.

⁴ The remainder of this paragraph is taken from an AASB staff analysis in Agenda paper 9.2, December 2009.

- liabilities arising from non-exchange revenue transactions are **not generally** financial liabilities. However, the IPSASB acknowledged that there may be **rare instances** where such transactions may give rise to financial liabilities and suggested that consideration of such issues could be considered in a future project (IPSAS 28 paragraphs BC22 and BC23). [emphasis added]

55. Because the Boards are still deliberating on ED 180/ED 118 *Income from Non-exchange Transactions (Taxes and Transfers)*, staff consider that it would be appropriate to defer making a decision about incorporating such guidance in AASB 132/ NZ IAS 32.

Application of the Process – paragraphs AG23-AG24

56. Paragraphs AG23-AG24 identify a number of types of obligations that are excluded from the scope of IPSAS 28 as follows:

- income taxes;
- social benefits;
- other statutory obligations; and
- constructive obligations.

57. The additional guidance in these paragraphs (over and above that already included in IAS 39 paragraph AG12), would not be of any value to Australian and New Zealand entities.

Application of the Process – Conclusion

58. Staff views on the application of the factors outlined in the *Process*, paragraph 22, to the additional guidance in IPSAS 28 paragraphs AG19-AG24 are set out in the following table.

Process (paragraph 22)	Comment
(a) an estimate of the significance of any modification on the financial statements	Non-exchange revenue – low. Transactions are significant for most PBE/NFP but no change in current practice expected. Statutory obligations – low. No change to current practice expected.
(b) an estimate of the significance of a transaction, event or circumstance on the financial statements taken as a whole	Statutory receivables – significant for all whole of government entities. Non-exchange revenue – low. See above. Statutory obligations – low. See above.
(c) whether or not a modification will increase or decrease internal consistency within IFRSs as modified for PBE/NFP	Statutory receivables – no impact. Non-exchange revenue – it would be inappropriate to introduce such guidance while a standard on non-exchange revenue is being developed.
(d) the costs of preparing the modification and the costs of requiring preparers, auditors and users to learn and apply two sets of requirements	There would be limited costs to prepare modifications based on paragraphs AG19-AG24. Increased preparation costs for any entity that would need to change their accounting policies.

Recommendations

59. It is recommended that the Boards:
- agree not to include in AASB 132 and NZ IAS 32, additional guidance on contractual arrangements (refer IPSAS 28 paragraphs AG19-AG20);
 - note that, as evidenced by previous discussions during the development of ED 180/ED 118, the Boards may not agree with the IPSASB's views regarding the likelihood and of financial liabilities arising from such transactions;
 - agree that any amendments to domestic standards to discuss the presentation or recognition and measurement of financial assets and financial liabilities arising from non-exchange revenue transactions should take place in the context of the joint project on non-exchange revenue;
 - agree not to include in AASB 132 and NZ IAS 32 additional guidance on the classification of assets and liabilities arising from non-exchange revenue transactions (refer IPSAS 28 paragraphs AG21-AG22);
 - note that, in IPSAS 28 the IPSASB has restructured paragraph AG12 of IAS 32 and included examples of other assets and liabilities that fall outside the scope of IPSAS 28; and
 - agree not to include in AASB 132 and NZ IAS 32 additional examples of obligations that are outside the scope of AASB 132 and NZ IAS 32 (refer IPSAS 28 paragraphs AG23-AG24).
60. *Do the Boards agree?*

IPSAS 28 Unissued currency (paragraph AG10)

Modification

61. IPSAS 28 provides clarification that unissued currency is not a financial instrument (paragraph AG10). It notes that IPSAS 12 *Inventories* applies to unissued currency. There is no equivalent guidance in AASB 132 or NZ IAS 32. However, NZ IAS 2 *Inventories* states that inventories held by PBEs may include stocks of unissued currency (paragraph NZ 8.1). AASB 102 *Inventories* does not include such guidance.

IPSASB's rationale

62. The inclusion of paragraph AG10 was not regarded as a significant change to IAS 32 – it is not mentioned in the Basis for Conclusions on IPSAS 28 or the Comparison between IPSAS 28 and IAS 32. An IPSAS staff paper noted that the guidance was to clarify the application of this Standard to cash held by a central bank.

Australian background

63. The Reserve Bank of Australia (RBA) is classified as a for-profit public-sector entity for purposes of financial disclosure. Although unissued currency is not separately disclosed in the RBA's 2009 financial statements the RBA does not classify unissued currency as a financial instrument. The RBA states that its financial instruments are its Australian dollar securities, foreign government securities, bank deposits, interest rate futures, foreign currency swap contracts, gold loans, cash and cash equivalents, notes on issue, deposit liabilities and its shareholding in the Bank for International Settlements.
64. The inclusion of additional NFP guidance in AASB 132 (based on IPSAS 28 paragraph AG10) would not lead to any change in the RBA's accounting policies as (i) it does not apply NFP specific requirements and (ii) it does not account for unissued currency as a financial instrument.

New Zealand background

65. The Reserve Bank of New Zealand (RBNZ) is classified as a PBE. It asserts compliance with Generally Accepted Accounting Practice in New Zealand and NZ IFRSs, but is unable to make an unreserved statement of compliance with IFRSs because it complies with the PBE specific requirements relating to inventory in NZ IAS 2. In accordance with NZ IAS 2 the RBNZ accounts for stocks of unissued currency as inventories held for distribution.

66. The inclusion of additional PBE guidance in NZ IAS 32 (based on IPSAS 28 paragraph AG10) would not lead to any change in the RBNZ's accounting policies as it already accounts for unissued currency as inventories held for distribution.

Application of the Process

67. Staff does not consider that it is necessary to apply the process to this IPSASB modification. As explained above, the additional guidance in IPSAS 28 would not change the accounting policies of the RBA or the RBNZ.

Recommendation

68. It is recommended that the Boards:
- note that the inclusion of additional guidance in AASB 132 or NZ IAS 32 on the treatment of unissued currency (as per IPSAS 28 paragraph AG10) would not change the accounting policies of either the Reserve Bank of Australia (because it is a profit-oriented entity) or the Reserve Bank of New Zealand (as it already accounts for unissued currency as inventory held for distribution);
 - agree that it is not necessary to apply the *Process* to this modification;
 - agree not to insert additional guidance on unissued currency in AASB 132 or NZ IAS 32; and
 - agree to consider the fact that NZ IAS 2 has guidance on unissued currency and AASB 102 does not when the Boards address later phases of Australia/New Zealand convergence.

IPSAS 28 Equity instruments (paragraphs AG25-AG27)

Modification

69. IPSAS 28, paragraphs AG25-AG27, includes additional Application Guidance that:
- explains the use of equity instruments in the public sector;
 - acknowledges the different forms of capital that exist in the public sector; and
 - clarifies that "equity instruments" refers to all instruments that evidence a residual interest in the net assets of an entity, including some liabilities.
70. There is no equivalent guidance in AASB 132 or NZ IAS 32. However AASB Interpretation 1038 *Contributions by Owners Made to Wholly-Owned Public Sector Entities* provides guidance on identifying contributions that are equity in nature. Accordingly, if the AASB decides to include the additional guidance in IPSAS 28, the AASB would, at the same time, need to decide what to do with Interpretation 1038.

IPSASB's rationale

71. The modifications made in paragraphs AG25-AG27 were not regarded as a significant change to IAS 32 – the changes are not mentioned in the Basis for Conclusions on IPSAS 28 or the Comparison between IPSAS 28 and IAS 32.
72. The intention was presumably to highlight the infrequent use of equity instruments in the public sector and the need to have evidence of a designation or formal agreement prior to recognising transfers of resources as equity/net assets.

Application of the Process

73. Staff views on the application of the factors outlined in the *Process*, paragraph 22, to the additional guidance in IPSAS 28 paragraphs AG25-AG27 are set out in the following table.

Process (paragraph 22)	Comment
(a) an estimate of the significance of any modification on the financial statements	Low – unlikely to have much impact on current accounting practices as limited additional guidance provided in IPSAS 28.
(b) an estimate of the significance of a transaction, event or circumstance on the financial statements taken as a whole	Low.
(c) whether or not a modification will increase or decrease internal consistency within IFRSs as modified for PBE/NFP	No impact.
(d) the costs of preparing the modification and the costs of requiring preparers, auditors and users to learn and apply two sets of requirements	Limited costs to prepare modification.

Recommendation

74. It is recommended that the Boards:
- note that the IPSASB has included additional application guidance in IPSAS 28 that explains the use of equity instruments in the public sector, acknowledges the different forms of capital that exist in the public sector, and clarifies that “equity instruments” refers to all instruments that evidence a residual interest in the net assets of an entity, including some liabilities;
 - agree that such additional guidance would be unlikely to change current financial reporting by NFP/PBE; and
 - agree not to insert additional guidance on equity instruments in AASB 132 and NZ IAS 32.

75. *Do the Boards agree?*

IPSAS 29 Financial Instruments: Recognition and Measurement

76. This section of the memo discusses the significant public sector modifications to the requirements of IAS 39 made by IPSASB in developing IPSAS 29. The modifications are summarised in the following table: the actual modifications are illustrated in agenda item B3.5. This memo recommends incorporating additional guidance on concessionary loans granted and received in AASB 139/ NZ IAS 39 *Financial Instruments: Recognition and Measurement* and AASB 9/ NZ IFRS 9 *Financial Instruments*.

IPSAS 29	AASB139/NZ IAS 39	Recommendation
<p>Scope – Financial guarantee contracts Refer IPSAS 28 table</p>	Refer IPSAS 28 table	No change.
<p>Non-exchange revenue transactions Excludes from the scope of IPSAS 29 rights and obligations that fall within the scope of IPSAS 23 (paragraph 2(j)).</p> <p>Requires that financial assets arising from non-exchange revenue transactions are measured at fair value in accordance with the principles in IPSAS 23 and taking account of transaction costs where appropriate (paragraph AG81). Adds an example to IPSAS 23.</p>	No guidance.	Review in context of ED 180/ED 118.
<p>Concessionary loans Contains Application Guidance on the recognition and measurement of concessionary loans, including how to account for the difference between the fair value of the loan and the transaction price (paragraphs AG84 to AG91 and IE40-IE41).</p>	There is currently no similar guidance in AASB 139/ NZ IAS 39 or AASB 9/ NZ IFRS 9. There is some guidance in the <i>NFP Illustrative Financial Statements</i> (NZICA, 2008) and the <i>Not for Profit Financial Reporting Guide</i> (NZICA, 2007).	<p>Mixed views:</p> <ul style="list-style-type: none"> ▪ FRSB staff recommend incorporating additional AG paragraphs in AASB 139/ NZ IAS 39 and AASB 9/ NZ IFRS 9 (for early adopters) but not the additional examples (IE do not form part of AASB 139/ NZ IAS 39). ▪ AASB staff recommend no change for AASB 139 and AASB 9.
<p>Financial guarantees Contains Application Guidance on the recognition and measurement of financial guarantee contracts entered into at no or nominal value (paragraphs AG92-AG97).</p>	No guidance.	No change.
<p>IFRIC 9 and IFRIC 16 IFRIC 9, “Reassessment of Embedded Derivatives” and IFRIC 16 “Hedges of a Net Investment in a Foreign Operation” have been included as authoritative appendices. The IPSASB does not promulgate Interpretations separately.</p>	Domestic equivalents to IFRIC 9 and IFRIC 16 already exist.	No change. <i>This modification is not discussed further in this memo.</i>

IPSAS 29 Non-exchange revenue transactions (paragraphs 2(j) and AG81)

Modification

77. IPSAS 29 excludes from its scope the initial recognition and initial measurement of rights and obligations arising from non-exchange revenue transactions which fall within the scope of IPSAS 23.
78. IPSAS 29 explains that financial assets resulting from non-exchange revenue transactions are initially measured in accordance with IPSAS 23 and IPSAS 29. IPSAS 29 paragraph AG81 states that any such financial assets are measured at fair value in accordance with the principles in IPSAS 23, taking account of transaction costs where appropriate. Because the IPSASB concluded in IPSAS 28 that liabilities arising from non-exchange revenue transactions are generally not financial liabilities, IPSAS 29 (paragraph AG6) does not provide any guidance on the initial measurement of financial liabilities arising from non-exchange transactions. If an entity has recognised a liability in respect of a condition on a cash transfer and subsequently decides that it will be required to return the funds to the donor, that liability falls within the scope of IPSAS 29 and is recognised and measured in accordance with that standard (refer IPSAS 29 paragraph AG6).

IPSASB's rationale

79. Paragraph AG81 was inserted to clarify the interaction between IPSAS 23 and IPSAS 29, specifically the issue of whether a financial asset arising from a non-exchange transaction should be initially recognised at fair value in accordance with IPSAS 23 or at fair value less transaction costs in accordance with IPSAS 29. This issue was identified by the AASB and FRSB in developing ED 180/ED 118.

Application of the Process

80. Because this issue arose in the context of ED 180/ED 118, staff proposes that it should be considered in that context.

Recommendation

81. It is recommended that the Boards:
- agree that any amendments to domestic standards in relation to the measurement of financial assets and financial liabilities arising from non-exchange revenue transactions should take place in the context of the joint project on non-exchange revenue; and
 - agree to defer consideration of IPSAS 29 paragraph AG81.
82. *Do the Boards agree?*

IPSAS 29 Concessionary Loans (paragraphs AG84-AG91 and IE40-IE41)

Modification

83. Concessionary loans are loans granted by entities on below market terms. IPSAS 29 includes guidance on concessionary loans (paragraphs AG84 to AG91). It also amends IPSAS 23 to clarify that concessionary loans are to be split into two components (exchange and non-exchange) with those components being treated as separate transactions.
- In the case of a concessionary loan received by an entity, the non-exchange component, being any difference between the fair value of the loan and the transaction price (the loan proceeds), is accounted for in accordance with IPSAS 23. The exchange component is recognised and initially measured in accordance with IPSAS 29.
 - In the case of a concessionary loan granted by an entity, IPSAS 29 requires that the non-exchange component, being the difference between the fair value of the loan and the transaction price (the loan proceeds), be treated as an expense. The exchange component is recognised and initially measured in accordance with IPSAS 29. The exception is where a concessionary loan granted is, in substance, an increase in an investment in a controlled entity.
84. After initial recognition, concessionary loans received or granted are measured in accordance with the requirements in IPSAS 29.

85. There is no equivalent guidance in AASB 139/ NZ IAS 39 or AASB 9/ NZ IFRS 9. PBE/NFP currently applying AASB 139/ NZ IAS 39 and AASB 9/ NZ IFRS 9 would have regard to the guidance in those standards regarding initial and subsequent measurement of loans granted (financial assets) and loans received (financial liabilities). The requirements of these standards in relation to concessionary loans are noted below.

If AASB 9/ NZ IFRS 9 not early adopted – AASB 139/ NZ IAS 39

- paragraph 43 requires that financial assets and financial liabilities be initially measured at fair value, plus, in some cases, transaction costs;
- paragraph 46(a) requires that financial assets that are loans and receivables be subsequently measured at amortised cost using the effective interest method;
- paragraph 47 requires that most financial liabilities be subsequently measured at amortised cost using the effective interest method;
- paragraphs AG64-AG65 provide guidance on the initial measurement of financial assets and financial liabilities;
- paragraphs AG66-AG68 provide guidance on the subsequent measurement of financial assets; and
- paragraphs AG69-AG82 provide guidance on fair value measurement considerations.

If AASB 9/ NZ IFRS 9 early adopted

Financial liabilities:

- AASB 139/ NZ IAS 39 paragraph 43 requires that financial liabilities be initially measured at fair value, plus, in some cases, transaction costs;
- AASB 139/ NZ IAS 39 paragraph 47 requires that most financial liabilities be subsequently measured at amortised cost using the effective interest method;
- AASB 139/ NZ IAS 39 paragraph AG64 provides guidance on the initial measurement of financial liabilities only;
- AASB 139/ NZ IAS 39 paragraphs AG69-AG82 continue to provide guidance on fair value measurement considerations;

Financial assets:

- AASB 9/ NZ IFRS 9 section 5.1 requires that financial assets be initially measured at fair value, plus, in some cases, transaction costs;
- AASB 9/ NZ IFRS 9 sections 4 and 5 establish subsequent measurement requirements for financial assets. Concessionary loans are likely to be classified as subsequently measured at amortised cost;
- AASB 9/ NZ IFRS 9 paragraphs B5.1 and B5.2 provide guidance on the initial measurement of financial assets – these paragraphs are almost identical to the previous guidance in AASB 139/ NZ IAS 39 paragraphs AG64-AG65; and
- AASB 9/ NZ IFRS 9 paragraphs B5.4 and B5.8 provide guidance on the subsequent measurement of financial assets. This guidance is not relevant for concessionary loans measured at amortised cost.

86. The Australian Government's policies for concessional loans is shown below:

On recognition, the fair values for these concessional loans was determined using the methods described below:

- Advances and loans reported by the Department of Resources, Energy and Tourism are obtained by reference to market prices that employ observable market transactions.
- Loans to State and Territory governments, including those reported by the Australian Office of Financial Management and the Department of Finance and Deregulation, are recognised at amortised cost. These transactions are not traded and, especially for those with the longest term to maturity, a direct market benchmark to underpin fair value measurement does not exist. Data on Treasury bonds are used in estimating fair value.

Subsequent to recognition, the above loans are carried at amortised cost which may differ to an updated fair value. Other concessional loans, including student loans provided under the Higher Education Loans Programme and home and business loans provided by Indigenous Business Australia, have been categorised as 'held at fair value through the profit and loss'. As such, the carrying amount of these loans is updated each reporting period to reflect fair value.

**Extract from the Commonwealth of Australia Consolidated
Financial Statements for the Year Ended 30 June 2009**

87. The Australian Government Department of Finance and Regulation has also issued *Accounting Guidance Note No. 2010/2* which specifies the treatment of concessional loans by Australian Government entities who issue concessional loans. The guidance is based on the requirements of AASB 132, AASB 139 and AASB 7. It includes examples and journal entries for initial and subsequent measurement.
88. A description of the New Zealand Government's policies for student loans is shown below:

Student loans are designated as loans and receivables.

...

Loans and receivables are recognised initially at fair value plus transaction costs and subsequently measured at amortised cost using the effective interest rate method (refer interest revenue policy). Loans and receivables issued with duration of less than 12 months are recognised at their nominal value, unless the effect of discounting is material. Allowances for estimated irrecoverable amounts are recognised when there is objective evidence that the asset is impaired. Interest, impairment losses and foreign exchange gains and losses are recognised in the statement of financial performance.

The student loans valuation model has been adapted to reflect current student loans policy. As such, the carrying value is sensitive to changes on a number of underlying assumptions, including future income levels, repayment behaviour and macro economic factors such as inflation and the discount rates used to determine the effective interest rate on new borrowers.

The data for valuation of student loans has been integrated from files provided by Inland Revenue Department, Ministry of Social Development and the Ministry of Education. The current data is up to 31 March 2008, and contains information on borrowings, repayments, income, educational factors, and socio-economic factors amongst others and has been analysed and incorporated into the valuation model. This integrated data has been supplemented by less detailed, but more recent data to value student loans at balance date. Given the lead time required to compile and analyse the detailed, integrated data, it is expected that there is a lag between the availability of this data set and balance date.

**Extract from the Financial Statements of the Government of New Zealand
for the year ended 30 June 2009**

IPSASB's rationale

89. IPSASB does not give a specific reason for including this additional guidance, other than to note that concessional loans pose particular accounting issues because their terms are not market related. Presumably IPSASB's intention was to make the application of the fair value principles in IAS 39 to concessional loans more explicit.

Application of the Process

90. In discussing this issue at its August 2010 meeting the FRSB expressed the following views:
- concessional loans are prevalent in all PBE sectors (including central government, local government and not-for-profit entities) and the private sector in New Zealand ;
 - the prevalence of concessional loans in the NFP sector in New Zealand led to the inclusion of guidance on accounting for such loans in the NFP Financial Reporting Guide and the NFP Illustrative Financial Statements;
 - the guidance in IPSAS 29 paragraphs AG84-AG91 is consistent with the requirements in IAS 39 and consistent with the way in which the requirements of IAS 39 have been applied in New Zealand;
 - the inclusion of additional guidance based on IPSAS 29 paragraphs AG84-AG91 in NZ IAS 39 would be unlikely to change current practice but would make it easier for PBEs to identify the appropriate treatment of concessional loans; and

- the IPSAS 29 guidance would not conflict with the proposals in ED 180/ED 118.
91. The FRSB supported the inclusion of guidance based on IPSAS 29 paragraphs AG84-AG91 in NZ IAS 39 but noted that the references to transactions with owners in paragraph AG89(b) were confusing and requested that staff consider this further. Staff agree that the wording is confusing and propose to remove references to transactions with owners. The proposed text is shown in the draft exposure draft at agenda item B3.2.
92. Staff views on the application of the factors outlined in the *Process*, paragraph 22, to the additional guidance on concessionary loans in IPSAS 29 are set out in the following table.

Process (paragraph 22)	Comment
(a) an estimate of the significance of any modification on the financial statements	Low financial impact as the modification would be unlikely to change current practice.
(b) an estimate of the significance of a transaction, event or circumstance on the financial statements taken as a whole	High – many PBE/NFP issue or receive concessionary loans.
(c) whether or not a modification will increase or decrease internal consistency within IFRSs as modified for PBE/NFP	No change to internal consistency.
(d) the costs of preparing the modification and the costs of requiring preparers, auditors and users to learn and apply two sets of requirements	Limited costs to prepare modification. Positive benefits expected for preparers as the modification should make it easier to identify appropriate requirements.

Recommendations

93. Staff have mixed views in making a recommendation.
94. AASB staff have been informed that Australian preparers and auditors in the public sector have been applying AASB 139 without the need for additional guidance on the accounting for concessionary loans, as evidenced by the Australian government's policy referred to in paragraph 86. In addition, the AASB previously dealt with the issue of public policy loans in 2008, in the context of 'Gaps in GAAP', and decided that there is no public sector specific reason to modify IFRSs. Accordingly, AASB staff recommend that the AASB agree not to insert additional guidance and illustrative examples on the accounting of concessionary loans in AASB 139, and if necessary, to deal with the issue in the context of the project on income from non-exchange transactions.
95. FRSB staff recommend that the Boards:
- agree to include in IFRSs as adopted in Australia and New Zealand additional guidance on the recognition and measurement of concessionary loans (based on IPSAS 29 paragraphs AG84-AG91) on the grounds that concessionary loans are prevalent in PBE/NFP and the proposed guidance is consistent with the way in which current requirements are being applied;
 - note that, if accepted, this recommendation would require amendments to AASB 139/ NZ IAS 39 and AASB 9/ NZ IFRS 9 (the proposed amendments are discussed further below); and
 - agree not to insert in AASB 139 and NZ IAS 39 additional IPSAS 29 Illustrative Examples on the grounds that the Illustrative Examples that accompany IAS 139 are not an integral part of AASB 139 and NZ IAS 39.
96. *Which recommendation do the Boards support?*

Proposed amendments

97. Following the promulgation of IFRS 9 *Financial Instruments* and the adoption of that standard in Australia and New Zealand, entities have the option of early adopting the requirements regarding financial assets in that Standard or continuing with their existing accounting policies in accordance with AASB 139/ NZ IAS 39. It would therefore be necessary to incorporate any additional guidance on the measurement of financial assets in both AASB 139/ NZ IAS 39 and AASB 9/ NZ IFRS 9.
98. It is proposed that the amendments be given effect by:
- including additional application guidance on concessionary loans granted (financial assets) and received (financial liabilities) in AASB 139/ NZ IAS 39 following paragraph AG 65. This amendment is required for those entities that are still applying AASB 139/NZ IAS 39 and have not early adopted AASB 9/NZ IFRS 9; and
 - amending Appendix C of AASB 9/NZ IFRS 9 which sets out amendments to other NZ IFRSs on adoption of NZ IFRS 9.

IPSAS 29 Financial Guarantees (paragraphs AG92 to AG97)

Modification

99. IPSAS 29, paragraphs AG92-AG97, includes additional Application Guidance on initial measurement of financial guarantee contracts entered into at no or nominal consideration. This guidance provides a fair value valuation hierarchy for measuring such financial guarantees. There are three levels to this valuation hierarchy:
- price in an active market;
 - a valuation technique; and
 - IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*.
100. There is no specific guidance in AASB 139 or NZ IAS 39 on accounting for financial guarantee contracts entered into at no or nominal consideration. PBE/NFP with financial guarantee contracts entered into at no or nominal consideration would apply the requirements of IAS 39. A table summarising the measurement requirements for financial guarantee contracts in IAS 39 and IPSAS 29 is set out below.

IAS 39 Financial guarantee contracts	IPSAS 29 Financial Guarantee contracts
<p>Initial measurement Fair value (paragraphs 43 and AG64) Guidance on fair value (paragraphs 48, 48A and AG69-AG82):</p> <ul style="list-style-type: none"> ▪ quoted prices in an active market ▪ valuation techniques 	<p>Initial measurement – normal Fair value (paragraphs 45) Guidance on fair value (paragraphs 50-51 and AG101-AG115):</p> <ul style="list-style-type: none"> ▪ quoted prices in an active market ▪ valuation techniques <p>Initial measurement – no or nominal consideration Determine carrying value in the same way as if no consideration had been paid (paragraphs 45 and AG94) Guidance on fair value (paragraphs AG94-AG97):</p> <ul style="list-style-type: none"> ▪ quoted prices in an active market ▪ valuation techniques ▪ apply principles of IPSAS 19
<p>Subsequent measurement paragraph 47(c) The higher of (a) the amount determined in accordance with IAS 37, and (b) the amount initially recognised under IAS 39 less, when appropriate, cumulative amortisation recognised in accordance with IAS 18 <i>Revenue</i>. IAS 39 also allows for the possibility of financial guarantee contracts being measured in accordance with paragraph 47(a)⁵ or 47(b)⁶.</p>	<p>Subsequent measurement – normal paragraph 49(c) The higher of (a) the amount determined in accordance with IPSAS 19, and (b) the amount initially recognised under IAS 39 less, when appropriate, cumulative amortisation recognised in accordance with IPSAS 9 <i>Revenue</i>. IPSAS 29 also allows for the possibility of financial guarantee contracts being measured in accordance with paragraph 49(a) or 49(b).</p> <p>Subsequent measurement – no or nominal consideration No difference.</p>

IPSASB's rationale

101. The IPSASB's rationale for providing such guidance is set out in IPSAS 29 paragraph BC15 (see below).

BC16. The IPSASB acknowledged that in the public sector financial guarantee contracts are frequently issued through a non-exchange transaction, i.e., they are issued for no consideration or for nominal consideration, often in order to further the issuer's broad social policy objectives, rather than for commercial purposes. While entities may issue guarantees at below fair value in the private sector, this is not common and is for commercial reasons, such as when a controlling entity issues a guarantee to a holder on behalf of a controlled entity. In the public sector the maximum credit risk exposure of such guarantees may be extremely large. Such guarantees are generally issued because an active market does not exist and, in some cases, it would be impossible for the guarantee to be provided by a private sector issuer because of the maximum extent of the credit risk exposure. The IPSASB considered the approach to measurement at initial recognition, and subsequent to initial recognition, for such financial guarantee contracts.

IPSAS 29 paragraph BC15

⁵ Financial liabilities at fair value through profit or loss. Such liabilities are generally measured at fair value.

⁶ Financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies.

Application of the Process

102. The FRSB considered this issue at its August 2010 meeting and expressed the following views:
- the FRSB was not convinced by the IPSASB's rationale for including the additional guidance;
 - the FRSB disagreed with the IPSASB's assertion that the issue of guarantees at below fair value is not common in the private sector;
 - some members considered that it is generally possible to develop a financial technique for such guarantees; and
 - the FRSB noted that the additional guidance in IPSAS 29 represents a modification to the measurement requirements of IAS 39 and could result in a different accounting treatment than under IAS 39.
103. The remainder of this section identifies examples of financial guarantees that could be affected if the IPSASB modification were to be adopted in AASB 139 and NZ IAS 39.
104. During the 2008-2009 financial year the New Zealand Government initiated the retail deposit scheme and the wholesale funding guarantee facility. Some, but not all, entities covered by each scheme paid consideration.
- Under the Retail Deposit Guarantee Scheme, fees are payable to the Government by participating institutions if they hold significant deposits (ie, greater than \$5 billion) or if they experience significant growth in deposits (ie, greater than 10% per annum).
 - Under the wholesale funding guarantee facility, the Government receives a fee from each participating institution based on the institution's credit rating and the term and amount of guaranteed debt issued.
- A provision has been recognised in respect of the Retail Deposit Guarantee Scheme only.
105. The Australian Government has provided guarantees under the:
- Financial Claims Scheme which provides depositors of authorised deposit-taking institutions and general insurance policyholders with timely access to their funds in the unlikely event of a financial institution failure;
 - Policyholder Compensation Facility which provides a mechanism for making payments to eligible beneficiaries with a valid claim against a failed general insurer; and
 - the Guarantee Scheme for Large Deposits and Wholesale Funding (coverage by this scheme is available for a fee).
106. The expected liability under the above guarantees is considered remote and unquantifiable and no provision is recognised in the financial statements of the Commonwealth of Australia for the year ended 30 June 2009. With respect to the Guarantee Scheme for Large Deposits and Wholesale Funding, the Australian Government has recognised contractual fee receivables and liability for its contractual obligation to provide a guarantee service over the period covered by each guarantee contract (analogous to unearned income).
107. At its August 2010 meeting the FRSB expressed the following views about IPSAS 29 paragraphs AG92-AG97:
- the FRSB disagreed with the IPSASB's assertion that such financial guarantee contracts are less prevalent in the private sector, although they acknowledged that certain public sector obligations may be larger than those occurring in the private sector;
 - the FRSB considered that the paragraphs AG92-AG97 establish measurement requirements that differ from the requirements in IAS 39; and
 - the FRSB expressed reservations about establishing different PBE/NFP measurement requirements in respect of such financial guarantees.
108. Staff views on the application of the factors outlined in the *Process*, paragraph 22, to the additional guidance in IPSAS 29 paragraphs AG92-AG97 are set out in the following table.

Process (paragraph 22)	Comment
(a) an estimate of the significance of any modification on the financial statements	Application of the IPSASB requirements would be unlikely to lead to the recognition of additional provisions. However the differing measurement requirements in IPSAS 29 could affect the amounts recognised in respect of such guarantees.
(b) an estimate of the significance of a transaction, event or circumstance on the financial statements taken as a whole	Potentially very significant for whole of government entities.
(c) whether or not a modification will increase or decrease internal consistency within IFRSs as modified for PBE/NFP	No change.
(d) the costs of preparing the modification and the costs of requiring preparers, auditors and users to learn and apply two sets of requirements	Limited cost to prepare modification.

Recommendation

109. It is recommended that the Boards:

- agree not to amend the measurement requirement in AASB 139/ NZ IAS 39 for financial guarantee contracts entered into at no or nominal consideration.

110. *Do the Boards agree?*

IPSAS 30 *Financial Instruments: Disclosures*

111. The significant public sector modifications made by IPSASB to the requirements of IFRS 7 in developing IPSAS 30 are set out in agenda item B3.6. The staff recommendations for incorporating these modifications in AASB 7 *Financial Instruments: Disclosures* and NZ IFRS 7 *Disclosures* are summarised in the table below.

IPSAS 30	IFRS 7	Recommendation/Comment
Scope – Financial guarantee contracts Refer IPSAS 28 table (paragraph 3)	Refer IPSAS 28 table	No change.
Concessionary loan disclosures Requires disclosures of concessionary loans granted, including reconciliations between opening and closing carrying amounts, the nominal value of loans, the purpose and terms of the various types of loan, and the valuation assumptions. (paragraph 37)	No disclosure required.	Mixed views: <ul style="list-style-type: none"> ▪ FRSB staff recommend amending AASB 7 and NZ IFRS 7. ▪ AASB staff recommend no change to AASB 7, consistent with the AASB staff recommendation in paragraph 94. If the AASB decides to insert additional guidance on concessionary loans in AASB 139, staff recommend that the disclosures be made relevant to Tier 1 entities only.

IPSAS 30	IFRS 7	Recommendation/Comment
<p>Additional disclosure— Provisions for financial guarantee contracts issued at no or nominal consideration AG5 requires disclosure of circumstances leading to a provision being recognised (under IPSAS 19) for a financial guarantee contract issued through a non-exchange transaction, where no fair value can be determined. (paragraphs 25 and AG5)</p>	<p>No disclosure required.</p>	<p>No change. This is consistent with the recommendation on IPSAS 29 not to amend the initial measurement requirements for financial guarantees issued at no or nominal consideration.</p>

IPSAS 30 Concessionary loan disclosures (paragraph 37)

112. IPSAS 30 paragraph 37, shown below, requires disclosures of concessionary loans granted. The effect of the disclosures required by paragraph 37 is to highlight the expenses associated with concessionary loans (being the fair value adjustment on initial recognition and impairment losses recognised).

37. Concessionary loans are granted by entities on below market terms. Examples of concessionary loans granted by entities include loans to developing countries, small farms, student loans granted to qualifying students for university or college education, and housing loans granted to low income families. For concessionary loans granted an entity shall disclose:
- (a) A reconciliation between the opening and closing carrying amounts of the loans, including:
 - (i) Nominal value of new loans granted during the period;
 - (ii) The fair value adjustment on initial recognition;
 - (iii) Loans repaid during the period;
 - (iv) Impairment losses recognized;
 - (v) Any increase during the period in the discounted amount arising from the passage of time; and
 - (vi) Other changes.
 - (b) Nominal value of the loans at the end of the period;
 - (c) The purpose and terms of the various types of loans; and
 - (d) Valuation assumptions.

IPSAS 30 paragraph 37

IPSASB's rationale

113. the IPSASB considered that because the intention of a concessionary loan, at the outset, is to provide or receive resources on below market terms, more comprehensive disclosures are required for concessionary loans granted. The IPSASB noted that such loans are a feature of the public sector and are often made to implement a government's or other public sector entity's social policies (refer IPSAS 30, paragraph BC5).

Application of the Process

114. Concessionary loans are prevalent in the PBE/NFP sectors. Although the impact of granting such loans would be recognised in the financial statements in accordance with AASB 139 and NZ IAS 39, there are currently no explicit requirements to disclose details of such loans. The IPSASB's purpose in requiring these disclosures would therefore be relevant in the Australian and New Zealand context.

115. The FRSB considered this issue at its August 2010 meeting and expressed the following views:
- requiring additional disclosure of concessionary loans would be consistent with the FRSB's support for including additional guidance on the recognition and measurement of concessionary loans in AASB 139/ NZ IAS 39; and
 - staff should consider the costs and benefits of the disclosures required by paragraph 37 before the Boards make a decision about amending AASB 139/ NZ IAS 39.

116. Staff views on the costs and benefits associated with the disclosures required by IPSAS 30 paragraph 37 follow.
117. Any disclosure requirement is associated with increased costs (for example, compilation and checking). As part of their existing accounting systems, entities will have the information required by IPSAS 30 paragraph 37. Registers of loans should include details of nominal amounts of loans, write downs on initial recognition, subsequent and amounts repaid. The question is the degree of difficulty for entities to extract these details from their accounting systems. This will depend on how information on concessionary loans is recorded by the entity and how many types of concessionary loans an entity is required to report.
118. The cost of extracting information from a system will be higher if details of different types of concessionary loans are recorded together or if concessionary and non-concessionary loans are recorded together. Entities making large numbers of concessionary loans will be more likely to record details of differing types of concessionary loans separately and assess impairment of those loans separately. Where concessionary loans are material, entities may already be making such disclosures. For example, the Australian Government and the Government of New Zealand both disclose write downs of student loans during the period. The New Zealand Government is also required to identify and seek approval for the fair value adjustment on initial recognition as part of the annual budget.
119. Australian Government reporting entities are already required to disclose the nominal value of concessional loans as well as the unexpired discount. These requirements are established by Section 45.7 of the Finance Minister's Orders.
120. Some of the information required by IPSAS 30 paragraph 37 is already required by IFRSs, albeit in a more aggregated form. For example:
- IFRS 7 paragraph 16 requires a reconciliation of changes in allowance accounts for credit losses *for each class of financial instruments*.
 - IFRS 7 paragraph 20(e) requires disclosure of impairment losses *for each class of financial instrument*.
 - IFRS 7 paragraph 25 requires disclosure of the fair value adjustment on initial recognition *for each class of financial instruments*.
 - IFRS 7 paragraphs 25 and 27 require disclosure of fair value of each class of financial instrument, and if a valuation technique is used, details of valuation assumptions applied in determining those fair values.
 - NZ IAS 1 requires disclosure of assumptions about the future
121. IPSAS 30 paragraph 37 requires disclosure of items for material concessionary loans rather than by class of financial instrument.
122. If the Boards wish to consider requiring disclosure of more information about concessionary loans but less detail than that required by IPSAS 30, staff considers that the following items provide the most useful information as they highlight the expenses incurred by an entity in relation to concessionary loans granted:
- the fair value adjustment on initial recognition (paragraph 37(a)(ii)); and
 - impairment losses recognised (paragraph 37(a)(iv)).
123. Application of the *Process*, paragraph 22, to the IPSASB concessionary loan disclosures is set out below.

Process (paragraph 22)	Comment
(a) an estimate of the significance of any modification on the financial statements	No impact on recognition or measurement. Additional disclosure.
(b) an estimate of the significance of a transaction, event or circumstance on the financial statements taken as a whole	Significance will vary across types of entities. Federal/State/Central government – high

Process (paragraph 22)	Comment
	significance (for example, student loans). Local government – incidence may vary but potentially significant. Local governments do make interest free or concessionary loans and have subsequent impairment of those loans. Private sector not-for-profit entities – incidence may vary but potentially significant (for example, Habitat for Humanity).
(c) whether or not a modification will increase or decrease internal consistency within IFRSs as modified for PBE/NFP	No impact on internal consistency of IFRSs as modified for PBE/NFP.
(d) the costs of preparing the modification and the costs of requiring preparers, auditors and users to learn and apply two sets of requirements	Limited costs to prepare modification – based on IPSAS 30 requirement. Additional disclosures usually increase preparer costs.

124. Other factors raised by the Boards at the joint meeting in April are discussed below.

Factors raised by Boards	Comment
Would making this modification now result in duplication of work (once the IPSASB reviews its standards in light of revisions being issued by the IASB)?	No. The IASB's project is focusing on recognition and measurement.
Would governments already be looking to IPSASs for guidance on this issue?	Possibly but any additional disclosures would be voluntary.
The Boards' long-term plans re IPSASs.	Potential IPSAS adoption by public sector entities and NFPs is still under review in New Zealand.

Recommendation

125. The staff have mixed views:

- FRBSB staff recommend requiring all the disclosures in IPSAS 30 paragraph 37. The alternative would be to require only the two items identified above; and
- AASB staff recommend not including any additional disclosure requirements as a consequence of our recommendation on concessionary loan guidance.

126. *The Boards are requested to provide feedback on IPSAS 30 paragraph 37.*

Additional disclosure of provisions for financial guarantee contracts issued at no or nominal consideration

IPSASB's rationale

127. IPSAS 30 requires disclosure of the circumstances leading to a provision being recognised (under IPSAS 19) for a financial guarantee contract issued through a non-exchange transaction, where no fair value can be determined (paragraph AG5(h)).

128. This modification was not considered significant enough to be explained in the Basis for Conclusions on IPSAS 30. The modification is consistent with the requirement in IPSAS 29 that where fair value cannot be determined for a financial guarantee contract, an entity measures a financial guarantee contract at initial recognition and subsequently in accordance with IPSAS 19. This measurement basis is in addition to the measurement bases permitted by IAS 39. The inclusion of an additional accounting policy disclosure in IPSAS 30 is consistent with the modifications in IPSAS 29.

Application of the Process

129. It is not appropriate to apply the *Process* separately to this issue.

130. If the earlier recommendation to adopt the IPSAS 29 measurement requirements for financial guarantee contracts is accepted, the additional disclosure in IPSAS 30 should also be adopted.

Recommendation

131. It is recommended that the Boards:

- agree not require additional disclosure of provisions for certain financial guarantee contracts as per IPSAS 30 paragraph AG5(h) on the grounds that these disclosures are linked to the requirements in IPSAS 29 paragraphs AG92-AG97 and the Boards do not propose to incorporate those IPSAS 29 requirements in IFRSs as adopted in Australia and New Zealand.

132. *Do the Boards agree?*