|  |  |  |  |
| --- | --- | --- | --- |
| FRD 114C |  |  | Financial instruments (May 2019) |
|  |  |  |  |
| Purpose |  | 1.1 | To mandate the transitional approach for the first-time application of AASB 9 *Financial Instruments*. |
|  |  | 1.2 | To prescribe the requirements for the classification and designation of financial assets and liabilities. |
|  |  | 1.3 | To mandate the application of the simplified approach to impairment of trade receivable and lease receivables. |
|  |  | 1.4 | For public financial corporations (PFCs), to mandate the requirement to apply AASB 1023 *General Insurance Contracts* to financial guarantee contracts previously asserted explicitly and accounted for as insurance contracts. |
| Application |  | 2.1 | Applies to all entities defined as either a public body or a department under section 3 of the *Financial Management Act 1994* except those entities which are not controlled by the State and whose financial position and result are thus not included in the Annual *Financial Report for the State of Victoria*. Application by those entities and by State owned companies formed under the Corporations Act is encouraged. |
| Operative date |  | 3.1 | Annual reporting periods commencing on or after 1 July 2018. |
|  |  | 3.2 | FRD 114B *Financial instruments – general government entities and public non financial corporatio*ns is withdrawn and superseded effective 1 July 2018. |
|  |  | 3.3 | FRD 116A *Financial Instruments – Public Financial Corporations* is withdrawn and superseded effective 1 July 2018. |
| Requirements |  | 4.1 | Retrospective application of AASB 9 classification and measurement requirements on initial date of application of AASB 9  An entity shall apply AASB 9 classification and measurement requirements retrospectively in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* to financial instruments in existence upon the initial date of application.  Comparative information shall not be restated. Any transitional differences shall be recorded as an opening retained earnings adjustment. |
|  |  | 4.2 | Prospective application of AASB 9 hedge accounting requirements on initial date of application of AASB 9  Formal hedge accounting shall not be applied unless an exemption from the Assistant Treasurer for this FRD has been granted. To obtain the exemption, an entity shall consult the Accounting Policy Team of DTF. Refer to section 5.1.  Where the exemption to this FRD has been granted, an entity shall apply AASB 9 hedge accounting requirements prospectively to new hedge relationships. Backdating hedge relationships on initial application date is prohibited. |
|  |  | 4.3 | Application of the simplified approach to impairment for all trade receivables, lease receivables and statutory receivables  All entities shall apply the simplified approach, which requires the loss allowance always be measured at an amount equal to lifetime expected credit losses for all trade receivables, lease receivables and statutory receivables. Statutory receivables are now deemed financial instruments as per Aus 2.1.1 of 2016-8. |
|  |  | 4.4 | Classification and designation of Financial Assets and Financial Liabilities  Financial assets and financial liabilities can be designated as an irrevocable designation (AASB 9, para’s 4.1.5 and 4.2.2 and B41.27) at initial recognition as FVTPL to eliminate an accounting mismatch. An entity shall assess an accounting mismatch prior to electing the fair value option.  Derivatives (other than those designated as an accounting hedge) shall be recognised as a financial asset or financial liability at FVTPL.  Financial Assets  Financial assets shall be reclassified when and only when the entity’s business model for managing its financial assets has changed such that its previous model would no longer apply. This does not apply to financial assets where an irrevocable designation has occurred.  Equity investments, defined in AASB132, para 11 (AASB 9 Appendix A), shall be classified and measured at fair value through net result (FVTPL) unless they are designated irrevocably on an asset-by-asset basis at initial recognition as fair value through other comprehensive income (FVOCI).  Debt investments shall be classified based on their contractual cash flow characteristics and the entity’s business model for managing them.  Debt investments whose cash flows do not represent solely payments of principal and interest (SPPI) shall be measured at FVTPL.  Debt investments that are held in line with the entity’s business objective which is neither to ONLY collect cash flows (held-to-collect business model) nor to BOTH collect cash flows AND sell (held-to-collect-and-sell business model) are measured at FVTPL.  Debt investments that meet both the SPPI test and held-to-collect business model test are measured at Amortised Cost.  Debt investments that meet both SPPI test and held-to-collect-and-sell business model test are measured at FVOCI.  Financial assets that are within the scope of AASB 9 and that support general insurance liabilities shall be reported at fair value through profit and loss, in accordance with AASB 1023, para.15.2. |
|  |  |  | Financial Liabilities  Financial liabilities shall be classified at amortised cost (AASB 9. Para 4.2.1) unless excluded under AASB 9 or have been irrevocably designated as FVTPL. Financial liabilities shall not be reclassified as per AASB 9 (4.4.2).  Where financial liabilities are designated at FVTPL, an entity shall identify the fair value changes attributable to its own credit risk and continue to monitor it as well as the accounting mismatch to determine whether fair value changes attributable to the entity’s own credit risk shall be presented in OCI (with no recycling) or net result. This is because if presentation of the fair value change in respect of the liability’s credit risk in OCI creates or enlarges an accounting mismatch in net result, gains and losses must be entirely presented in net result. |
|  |  | 4.5 | The following are excluded from the above requirements:   1. interests in subsidiaries, associates and joint ventures; employers’ rights and obligations under employee benefit plans, finance leases and liabilities under insurance contracts or other types of financial instruments excluded from the scope of AASB 7 and AASB 9; 2. financial instruments for which the Consolidated Analysis and Reporting team of DTF has given the entity prior written approval to treat in a particular way. |
|  |  | 4.6 | Financial guarantees as insurance contracts – applicable for PFCs only  An entity shall apply AASB 1023 *General Insurance Contracts* to its financial guarantee contracts if it has previously asserted explicitly that it regards such contracts as insurance contracts accounted for in accordance with AASB 1023. |
| Definitions |  | 5.1 | **Derivative** – A financial instrument or other contract within the scope of this Standard with all three of the following characteristics:   * + 1. its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the ‘underlying’);     2. it requires 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     3. it is settled at a future date. |
|  |  |  | **Financial guarantee contract** – 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. |
|  |  |  | **Hedge accounting** – An accounting technique that recognises gains and losses on associated hedging instruments and hedged items in net result (or OCI) in the same accounting period to eliminate or reduce the volatility in the statement of comprehensive income that otherwise would arise if the hedged item and the hedging instrument were accounted for separately. Hedge accounting allows entities to mitigate the profit or loss effect arising from financial instruments used for hedging. The existence of an economic hedge (e.g. entities entering into a cross-currency swap to convert the fixed rate foreign currency loan to a domestic floating rate loan to eliminate interest rate risk and currency risk components of its foreign currency borrowing) does not mean that an entity may automatically apply hedge accounting. AASB 9 requires compliance with certain prerequisites before hedge accounting could be applied. |
|  |  |  | **Hedge accounting restrictions**  Entities shall not apply hedge accounting unless an exemption from this FRD has been obtained. Entities, however, may consider whether hedge accounting would provide benefits and if so consult the Accounting Policy Team of DTF prior to applying for exemption from this FRD to apply hedge accounting.  This recommendation to avoid the use of formal hedge accounting should not discourage an entity from entering into derivative financial instruments to manage financial risks, such as its interest rate or currency risks inherent in its borrowing or asset management activities. There shall be consistency in the way that the derivatives and the underlying instruments concerned are recorded, measured and values adjusted. |
| Relevant pronouncements |  |  | AASB 7 *Financial Instruments: Disclosures* (December 2017)  AASB 9 *Financial Instruments* (December 2014)  AASB 101 *Presentation of Financial Statements* (December 2017)  AASB 132 *Financial Instruments: Presentation* (August 2015) |
| Current background |  |  | This FRD was revised in April 2019 to reflect the first-time adoption of AASB 9 *Financial Instruments* (2014) which replaced AASB 139 *Financial Instruments – Recognition and Measurement*. It applies to the reporting periods beginning on or after 1 January 2018.  AASB 9 makes the following changes to AASB 139 requirements for classification and subsequent measurement of financial assets and liabilities, including:  Simplified new model for classifying and measuring financial assets at Amortised Cost, FVOCI, and FVTPL;  Fair value attributable to the issuer’s credit risk for financial liabilities designated at FVTPL to be presented in OCI, unless OCI presentation would create or enlarge an accounting mismatch;  New forward looking ‘expected credit loss’ impairment loss model, replacing the ‘incurred loss’ model under AASB 139;  New hedge accounting criteria that are more aligned to risk management and treasury operations and simpler to apply; and  Additional disclosure requirements under AASB 7 as the result of above mentioned changes. |
|  |  |  | With limited exceptions, AASB 9 must be applied retrospectively in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*. It applies to all financial instruments in existence as at the transition date. Comparatives are not required to be restated and transition differences are recorded as an opening retained earnings adjustment. It is at the transition date that the various elections and designations are required to be made. |
| Historical background |  |  | This FRD came into effect in the first annual reporting period beginning on or after 1 January 2005. Although AASB 1 requires prior period information to be restated, the State of Victoria elected to apply the exemption allowed under AASB 1 to not restate information required under AASB 132 and AASB 139.  Post transition, additional disclosure requirements arise principally in areas of fair value through other comprehensive income, investments in equity instruments, impairment and hedge accounting. This FRD came into effect in the first annual reporting period beginning on or after 1 January 2005. Although AASB 1 requires prior period information to be restated, the State of Victoria elected to apply the exemption allowed under AASB 1 to not restate information required under AASB 132 and AASB 139.  If a hedge of a purchase or sale of a capital item or any other unrecognised firm commitment or highly probable forecast transaction subsequently results in the recognition of a non financial asset or non financial liability, then the standard allows an entity to either (a) reclassify hedging gains/losses into profit/loss in the same periods in which the asset or liability affects profit/loss; or (b) transfer the hedging gains/losses into the initial carrying amount of the asset/liability. This FRD limits the choice to Option (b) to ensure consistency and that the cost of the asset reflects any hedging performed.  Until the introduction of A IFRS, the market borrowings held by TCV were revised to amortised cost on consolidation in the *Financial Report for the State of Victoria*. Commencing with 2005-06, there shall be no adjustment to these liabilities and consequently these borrowings shall be recorded at fair value in the *Financial Report for the State of Victoria*.  This FRD was revised in June 2016 to remove the first time adoption requirements as they are no longer required. References to comparative information were removed as it applies to transitional periods. The ‘Model for Disclosure within Financial Report’ section was also removed as this disclosure has been included in the *Model Report for Victorian Government Departments*. |