XRB | Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Accounting for non-complex financial instruments

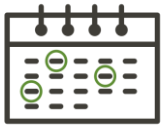
A helpful guide for Public Benefit Entities applying PBE IPSAS 41 for the first time.

All organisations will hold some form of financial instruments such as, financial assets like bank accounts, accounts receivable, term deposits, loans, shares and bonds. Financial instruments will also include financial liabilities such as accounts payables and loans.

Overview: PBE IPSAS 41 Financial Instruments

PBE IPSAS 41 replaces PBE IPSAS 29 Financial Instruments: Recognition and Measurement and reflects the latest international developments and best practice on how to recognise and measure the different types of financial instruments held by public benefit entities (PBEs) in Aotearoa New Zealand.

The new Standard was issued by the XRB in 2018 and is required to be applied from accounting periods beginning on or after **1 January 2022.**



What's changing?

- A new, simpler model for classifying and measuring financial assets
- A new, more forward-looking way of calculating allowances for doubtful debts
- A new, less restrictive, hedge accounting model
- New disclosure requirements

What will this mean for you?

Financial assets may need to be reclassified using the new model.

Allowances may need to be re calculated to reflect expected credit losses – which could mean recognising doubtful debts earlier.

If you use hedge accounting, you can adopt the new hedge accounting requirements (which are less restrictive), or continue using the old hedge accounting requirements in PBE IPSAS 29.

Your disclosure requirements will depend on the type of financial instruments you hold, and which Tier level your entity comes under.

Frequently asked questions

Why do we need a new standard on financial instruments?

International standard setters have simplified the classification and measurement of financial assets. They also developed a more forward-looking approach to calculating allowances for doubtful debts, with a view to reducing the risk of overstated assets. PBE IPSAS 41 reflects these new requirements and is expected to result in higher-quality reporting on financial instruments.

How is the classification model in PBE IPSAS 41 different?

Under the old classification model, each category had its own set of rules for determining whether a financial asset should be classified in that category. Under the new model, classification and measurement for all categories of financial assets is based on two key principles:

a) The solely payments of principal and interest (SPPI) test; and

b) the business model test.

These principles will determine whether the asset will be categorised and measured using 'amortised cost' or 'fair value'.

How will the allowance for doubtful debts for accounts receivable be calculated under the new standard?

Previously, the allowance for doubtful debts was based on *incurred losses*. Under the new standard, the allowance for doubtful debts is based on *expected credit losses*. This means an allowance for doubtful debts is recognised based on possible future defaults and how likely they are to occur. Therefore, an allowance for doubtful debts may need to be recognised even for receivable balances that are not yet 'past due'.

How do I account for investments in shares under PBE IPSAS 41?

Shares are measured initially and at the end of each year at fair value, which is the price at which the shares would be sold between knowledgeable, willing parties in an arm's length transaction, for example, the share price quoted on the stock exchange. However, movements in the fair value of shares are recognised either in surplus or deficit, or in other comprehensive revenue and expense – depending on how investments are managed.

Will accounting for bank term deposits change under the new standard?

No. The new standard does not change the initial recognition of a term deposit. Generally, term deposits are initially recognised at the amount that is deposited with the bank. After initial recognition, term deposits will generally continue to be measured at amortised cost – meaning that interest accrues on the deposit balance as earned.

Does this change accounts payable and loan liabilities?

No. The accounting requirements for accounts payable (creditors) and loan liabilities does not change. Accounts payable will continue to be measured at 'amortised cost'. In practice, this will be the amount that is paid as per the supplier invoice.

Loan liabilities will generally continue to be accounted in the same way as under the old requirements, i.e. at amortised cost. In practice, this will be the remaining principal of the loan, plus the accrued interest.

You can find more detailed questions and answers on our website.

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