Institute of Chartered Accountants of New Zealand

FINANCIAL REPORTING STANDARD NO. 33
1997

DISCLOSURE OF INFORMATION BY FINANCIAL INSTITUTIONS

Issued by the Financial Reporting Standards Board of the Institute of Chartered Accountants of New Zealand

Approved April 1997 by the Accounting Standards Review Board under the Financial Reporting Act 1993

CONTENTS

	Paragraph
Introduction	1.1
Application	2.1
Statement of Purpose	3.1
Definitions	4.1
Accounting Policies	5.1
Financial Instruments	5.2
Commodity Instruments	5.6
Impaired Assets and Provisions	5.7
Financial Performance	6.1
Financial Position	7.1
Assets	7.1
Liabilities	7.7
Unrecognised Financial Assets, Financial Liabilities and Commodity Instruments	8.1
Disclosures Concerning Fair Value	9.1
Asset Quality	10.1
Management of Liquidity	11.1
Disclosures Concerning Exposure to Currency and Interest rate Risk	12.1
Disclosures Concerning Credit Exposure	13.1
Concentrations of Funding	14.1
Managed Fund, Securitisation, Custodial, and Other Fiduciary Activities	15.1
Transitional Provision	16.1
Comparison of FRS-33 with International and Australian Accounting Standards	Appendix

This Financial Reporting Standard should be read in the context of the Explanatory Foreword to General Purpose Financial Reporting published by the Council, Institute of Chartered Accountants of New Zealand.

The Accounting Standards Review Board (the Board) has approved FRS-33: Disclosure of Information by Financial Institutions, for the purposes of the Financial Reporting Act 1993, to apply to all reporting entities, the Crown and all departments, Offices of Parliament and Crown entities (each of which is defined in the Act).

The Board has also approved this Standard to apply to local authorities (as defined in the Act) from 1 July 1998.

1 INTRODUCTION

COMMENTARY

1.1 This Standard deals with disclosures in the general purpose financial reports of financial institutions.

1.2 Financial institutions represent a significant and influential sector of economic activity. Most individuals and organisations make use of financial institutions, for example, as depositors, borrowers, investors, or as users of payments services. Hence, besides shareholders and ordinary creditors, there is considerable interest among a wide range of other parties in the performance, financial position, and financing and investing activities of financial institutions, particularly their solvency and the relative degree of risk attaching to their different activities. For a financial institution, risk is related to the assets and liabilities recognised in its statement of financial position, off-balance sheet activity and the manner in which the business is managed.

1.3 A financial institution is exposed to various types of risk, such as risk arising from counterparty failure, funding and asset concentrations, interest rate movements, changes in other market prices, and from an inability to meet obligations as they fall due (liquidity risk). Other entities have exposures to these risks as well, to varying degrees. However, for financial institutions the magnitude of those risks is generally greater. As financial institutions are also generally more highly geared than other commercial entities, their capacity to absorb losses arising from such risks is not as great as other entities. The operations, and thus the accounting and reporting requirements, of financial institutions are different from those of other commercial enterprises.

1.4 Financial reporting standards are paragraphs in bold type-face in this Standard. Where appropriate, interpretative commentary paragraphs in plain type-face follow the financial reporting standards.

2 APPLICATION

STANDARD

2.1 This Standard applies to the general purpose financial reports of all entities that are financial institutions except for interim general purpose financial reports. However, this Standard also applies to half year reports

that are prepared by registered banks in accordance with reporting requirements established by the Reserve Bank of New Zealand.

COMMENTARY

2.2 This standard applies to group financial reports if the group is a financial institution (refer paragraph 4.16).

2.3 Where the activities of a financial institution, such as a friendly society, include life insurance activities, the financial institution is encouraged to adopt appropriate accounting practice with regard to the measurement and disclosure of information relating to its life insurance activities, to the extent such accounting practice does not conflict with the requirements of this Standard.

STANDARD

2.4 The financial reporting standards set out in this Standard shall apply to all financial reports where such application is of material consequence. A statement, fact, or item is material if it is of such a nature or amount that its disclosure, or the method of treating it, given full consideration of the circumstances applying at the time the financial report is completed, is likely to influence the users of the financial reports in making decisions or assessments.

2.5 Where a financial institution prepares general purpose financial reports, they shall be prepared in conformity with New Zealand financial reporting standards. In the event of a conflict between the disclosure requirements of this Standard and the disclosure requirements contained in other financial reporting standards, the provisions of this Standard shall prevail.

2.6 This Standard applies to general purpose financial reports covering periods commencing on or after 1 April 1997.

3 STATEMENT OF PURPOSE

COMMENTARY

3.1 The purpose of this Standard is to prescribe minimum standards of disclosure for financial institutions. Financial institutions use differing methods for the recognition and measurement of items in their financial statements. While standardisation of these methods is desirable, it is beyond the scope of this Standard.

4 DEFINITIONS

STANDARD

The following terms are used in this Standard with these meanings:

4.1 "Asset acquired through the enforcement of security" is any asset which is legally owned as the result of enforcing security, other than a building occupied by the financial institution.

COMMENTARY

4.2 Where a financial institution assumes ownership of an asset in settlement of all or part of a debt, that asset is regarded as an asset acquired through the enforcement of security provided that the asset is not a building occupied by the financial institution. Buildings acquired through the enforcement of security, but occupied by the financial institution, are regarded as fixed assets and are not included in this definition. An asset acquired through the enforcement of security must be owned outright, and accordingly does not include "mortgagee in possession" assets. In most cases, assets acquired through the enforcement of security consist of land and buildings not occupied by a financial institution (known as "real estate assets acquired through the enforcement of security"), but other types of assets may also be acquired through security enforcement, such as motor vehicles, and plant and machinery.

STANDARD

4.3 A "class" of assets or liabilities is a category of assets or liabilities which has a similar nature or function in the operations of the reporting entity.

4.4 "Commodity instrument" is any contract that provides for settlement only by receipt or delivery of a physical asset.

4.5 A "contract" includes any agreement, commitment, or obligation.

4.6 "Counterparty" is any other party to a contract with the entity reporting.

4.7 "Credit exposure" is the amount of the maximum loss that a party to a contract could incur as a result of the counterparty to that contract failing to discharge its obligations.

COMMENTARY

4.8 This Standard requires disclosure of recognised and unrecognised credit exposures arising from contracts of both a financial nature and a non-financial nature. The types of contracts on which a credit exposure can be incurred include: a receivable, an irrevocable commitment to lend or provide other financial services, an unrecognised liability, and a market-related contract. Market-related contracts include futures, forwards, swaps and options to purchase or sell foreign exchange, interest rate or equity instruments, or commodities such as precious metals, wool and other physical assets. The credit exposure on both recognised and unrecognised market-related contracts is the cost of replacing those contracts.

STANDARD

4.9 "Credit exposure to an individual counterparty or group of closely related counterparties" is the amount of the maximum loss that could be incurred under all contracts with that counterparty or group of closely related counterparties in the event of those counterparties failing to discharge their obligations.

4.10 "Credit risk" is the risk of loss arising from one party to a contract failing to discharge its obligations under that contract.

4.11 "Currency risk" is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates.

4.12 "Equity" is the residual interest in the assets of the entity after deduction of its liabilities.

4.13 An "equity instrument" is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities, but does not include the following financial instruments:

(a) investments in subsidiaries, in-substance subsidiaries and associates;

(b) investments in partnerships and joint ventures.

4.14 "Fair value" is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

4.15 "Financial asset" is any asset that is:

(a) cash;

(b) a contractual right to receive cash or another financial asset from another entity;

(c) a contractual right to exchange other financial instruments with another entity under conditions that are potentially favourable; or

(d) an equity instrument of another entity.

4.16 "Financial institution" is any entity whose principal activity is to obtain funds with the objective of lending or investing in financial assets other than equity instruments, but excluding:

(a) entities which are wholly funded and controlled by a related party or parties and which do not engage in activities that give rise to material unrecognised financial liabilities with counterparties which are not related parties; or

(b) general insurers, life insurers, and superannuation schemes.

COMMENTARY

4.17 Financial institutions are traditionally identified as those entities which accept funds from individuals and organisations with the objective of lending the funds obtained to other parties, or otherwise investing the funds, so as to generate returns to the entity. Banks, building societies, credit unions, finance companies, money market dealers, and merchant banks are typical examples of financial institutions as defined in paragraph 4.16.

4.18 The term "obtaining funds" includes within the scope of funding activities investment securities issued by unit trusts and other managed funds, as well as

equity instruments that represent in-substance deposits, such as shares issued by building societies and credit unions (shares issued by these entities are normally fixed in amount, and redeemable on demand at the option of the holder).

4.19 The definition also includes other types of entities which are broadly involved in financial intermediation. For example, entities which undertake a primary function of borrowing funds for on-lending to related parties with the ultimate objective of reducing the cost of borrowing for those entities. This means that intra-group financiers are normally regarded as financial institutions. However, entities which are wholly funded (excluding trade creditors in the normal course of business) and controlled by related parties are not financial institutions unless such entities have material unrecognised financial liabilities with unrelated counterparties.

4.20 The definition of financial institution refers to investment in financial assets, but excludes investment in the equity instruments of other entities. Financial assets comprise a wide range of assets, including loans and advances, investments in securities, and unrecognised assets relating to financial contracts. This means that entities such as unit trusts whose principal activity is to undertake mortgage lending, or to manage cash, are covered by the scope of the definition. However, entities which raise funds principally for investment in physical assets, such as real estate or plant and equipment, or for exploration or production activities, are not financial institutions.

4.21 Entities which invest principally in equity instruments are not regarded as financial institutions. Disclosures required by this Standard because they are of particular relevance to financial institutions, such as disclosures concerning interest rate risk and impaired asset disclosures, are of less significance to entities which invest principally in equity instruments. This approach means that entities which hold shares in related entities as their principal activity, as well as entities which principally invest in or trade equity instruments, are not financial institutions for the purpose of this Standard.

4.22 Certain types of entities are specifically exempted from the coverage of this Standard. Superannuation schemes are exempted because reporting requirements for those entities are contained in a separate financial reporting standard (FRS-32: *Financial Reporting By Superannuation Schemes*). This Standard also does not apply to life and general insurance entities because the nature of their business generates special reporting requirements. Friendly societies are regarded as financial institutions if their principal activity meets the requirements set out in paragraph 4.16.

STANDARD

4.23 "Financial instrument" is any contract that gives rise to both a recognised or unrecognised financial asset of one entity and a recognised or unrecognised financial liability or equity instrument of another entity.

4.24 "Financial liability" is any liability that is a contractual obligation:

(a) to deliver cash or another financial asset to another entity; or

(b) to exchange financial instruments with another entity under conditions that are potentially unfavourable.

4.25 "General provision" is an amount that has been created to meet unidentified credit losses.

4.26 "Group of closely related counterparties" is a group of legal or natural persons, one or more of which is a counterparty, who are related in such a way that:

(a) the financial soundness of any one of them may materially affect the financial soundness of the other(s); or

(b) one has the power to control the other(s); or

(c) one has the capacity to exercise significant influence over the other(s).

4.27 "Impaired asset" is a non-accrual asset, a restructured asset, a real estate asset acquired through the enforcement of security, or an other asset acquired through the enforcement of security.

4.28 "Interest rate risk" is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates.

4.29 "Investment security" is a security which a financial institution intends to hold for the long term or to maturity.

4.30 "Maximum loss", in relation to paragraphs 4.7 and 4.9, is the loss to which a party is exposed without taking into account the value of collateral, guarantees, indemnities, other support arrangements, and any potential recoveries. However, a financial asset may be offset against the amount of the maximum loss if the criteria for offsetting monetary items, specified in FRS-27: *Right of Set-off*, are met.

COMMENTARY

4.31 For the purposes of this standard, maximum loss may be interpreted as the maximum counterparty limit under the contract.

STANDARD

4.32 "Non-accrual asset" is any asset for which the financial institution will not be able to collect all amounts owing in accordance with the terms of the contract with the counterparty.

COMMENTARY

4.33 When a financial institution expects to incur a loss as a result of extending credit to a customer, whether the loss be in the form of interest, principal, or other forms of monies owing to the financial institution, the facility is regarded as a "non-accrual asset" and associated revenues and expenses are recognised on a cash accounting basis.

4.34 An assessment should be made on the collectability of any amounts owing to the financial institution before a credit exposure can be categorised as a "non-accrual asset". The circumstances in which it is expected that monies owing will not be paid are a matter for judgement and will depend, among other factors, on the nature of the institution's customer relationships, and on the nature of the contractual terms and conditions particular to the financial instruments or facilities involved. For example, it is common practice for loans to be classified as non-accrual assets and placed on a non-accrual status where payments of principal and interest owed under the loan contract have been in arrears for 90 or more consecutive days; and for overdrafts to be placed on non-accrual status when the overdraft has been continuously outside of approved limits for 90 or more consecutive days. However, even where a customer is current with contractual payments, exposures to that customer may still be placed on a cash accounting basis because a significant deterioration in the financial performance or position of the customer has indicated to management that a loss is expected at some future point in time.

4.35 In assessing whether a loss is expected, financial institutions should take into account the value of security held. If the amount of security held in respect of a non-performing facility adequately covers all amounts owing to the financial institution, including unpaid principal, interest in arrears, or other forms of monies owing, then a loss is not expected to be incurred and by definition the facility could not be regarded as a non-accrual asset. However, in that case consideration would then need to be given to classifying the facility as a past-due asset.

STANDARD

4.36 "Other asset acquired through the enforcement of security" is any asset acquired through the enforcement of security, other than a "real estate asset acquired through the enforcement of security".

4.37 "Other security" is a security which a financial institution does not intend to hold for the long term or to maturity.

4.38 "Past-due asset" is any asset which has not been operated by the counterparty within its key terms for at least 90 days and which is not an impaired asset.

4.39 "Real estate asset acquired through the enforcement of security" is a land or building asset acquired through the enforcement of security.

4.40 "Restructured asset" is any asset which is not a non-accrual asset and for which:

(a) the original terms have been changed to grant the counterparty a concession that would not otherwise have been available, due to the counterparty's difficulties in complying with the original terms; and

(b) the revised terms of the facility are not comparable with the terms of new facilities with comparable risks; and

(c) **the yield on the asset following restructuring is equal to, or greater than, the institution's average cost of funds, or that a loss is not otherwise expected to be incurred.**

COMMENTARY

4.41 Where concessionary terms and conditions on an asset have been formally granted to a customer because of the customer's financial difficulties, and the return on the asset following restructuring is such that a loss is not expected to be incurred, then the asset is to be regarded as a restructured asset.

4.42 Concessionary terms and conditions granted include formal forgiveness of some principal and interest, or other types of cash flows; a deferral or extension of interest or principal payments; a reduction of interest; and an extension of maturity date. However, a key feature of these assets is that following restructuring, the return under the revised terms and conditions is expected to be equal to, or greater than, the institution's average cost of funds, or that a loss is not otherwise expected to be incurred; if not, the facility must be classified as a non-accrual asset.

4.43 If an asset is restructured so that it is expected that the customer will perform on terms which are similar to those for new facilities of similar risk, and no provisions are currently held against the exposure, then no loss is expected to be incurred and accordingly the exposure may be regarded as fully performing.

STANDARD

4.44 "Specific provision" is an amount which has been created against identified credit losses or in respect of an identified deterioration in the value of any asset or class of asset attributable to an increase in credit risk.

COMMENTARY

4.45 In the case of some classes of assets, such as a mortgage portfolio, it may not be practicable for a financial institution to create a specific provision by reviewing the creditworthiness of each borrowing customer in that portfolio. Instead, a financial institution may establish a provision for such a class of assets on some other basis, such as the historical loan losses for the asset class. Provisions established in this way nevertheless should be regarded as specific provisions. If more than one balance sheet caption is being provided against, the relevant specific provision should be allocated in proportion to the credit exposures subsisting in each category.

4.46 As a general rule, where specific provisions have been raised against unrecognised assets, they should be presented as liabilities in the statement of financial position, along with a note explaining the nature and amount of those provisions. A special case arises where a specific provision has been raised to cover both recognised and unrecognised assets or classes of assets, and those provisions in total exceed the amount of recognised assets being provisioned. In

this circumstance, the amount of the exposure accounted for as a recognised financial asset should be fully netted off against the provision in the statement of financial position, with the remaining balance of the specific provision presented as a liability. A net specific provision complies with the recognised liability definition contained in the *Statement of Concepts for General Purpose Financial Reporting*.

FINANCIAL REPORTING

5 ACCOUNTING POLICIES

STANDARD

5.1 As part of a financial institution's statement of accounting policies required by FRS-1: *Disclosure of Accounting Policies,* particular accounting policies shall address and disclose, as a minimum, the accounting policies for the items listed in paragraphs 5.2 and 5.6 to 5.10 below.

Financial Instruments

STANDARD

5.2 A financial institution shall disclose the accounting policies for financial instruments with respect to:

(a) the basis for recognising revenues and expenses (including gains and losses);

(b) the basis for recognising financial instruments in the financial reports, or for treating financial instruments as unrecognised items; and

(c) the basis of valuation.

COMMENTARY

5.3 FRS-1: *Disclosure of Accounting Policies*, requires that financial reports include clear and concise statements of all material accounting policies adopted. This is of particular importance for financial instruments because of the wide variety of instruments that exist and the potential for different policies to be followed depending on the purpose for which a particular transaction is undertaken. Also, the existence of material credit exposures that may not be reflected in the statement of financial position reinforces the need for a clear explanation of the policies followed in deciding whether an item qualifies for recognition. Elaboration of the matters to be addressed in the statement of accounting policies is warranted for financial institutions because their business involves principally the use of financial instruments.

5.4 Matters that should be addressed in the disclosure of accounting policies on the recognition of revenues and expenses with respect to financial instruments include:

(a) accounting policies for interest revenue and expense, including policies on inter-period allocations of interest revenue and expense;

(b) accounting policies for fee revenue and expenses distinguishing between yield related and non-yield related items, and policies in relation to inter-period allocations; and

(c) accounting policies for recognising gains or losses on investment securities and other securities.

5.5 Matters that should be addressed in the disclosure of accounting policies on the recognition of financial instruments or their off-balance sheet treatment include:

(a) classification and measurement of investment and other securities;

(b) accounting for sale and repurchase agreements, reverse sale and repurchase agreements or their option derivatives;

(c) whether securities are accounted for on a trade or settlement date basis;

(d) accounting for financial instruments which are used for hedging purposes;

(e) accounting for leases;

(f) accounting for foreign exchange contracts, interest rate contracts, and derivative instruments such as options, futures, forwards and swaps;

(g) accounting for acceptances and endorsements of bills of exchange; and

(h) accounting for loan transfers and securitisation of financial assets.

Commodity Instruments

STANDARD

5.6 A financial institution shall disclose the accounting policies for commodity instruments with respect to:

(a) the basis for recognising revenues and expenses (including gains and losses);

(b) the basis for recognising commodity instruments in the financial reports, or for treating commodity instruments as unrecognised items;

(c) the basis of valuation.

Impaired Assets and Provisions

STANDARD

5.7 A financial institution shall disclose the accounting policies for impaired assets, including criteria used to classify those assets, and policies for recognising and determining their carrying amounts in the statement of financial position.

5.8 A financial institution shall disclose the accounting policies for determining specific and general provisions for both recognised and unrecognised assets, and the basis on which those provisions are recognised

in the financial statements. In particular, disclosures shall address whether specific provisions are based on identification on a counterparty by counterparty basis, an estimation in relation to a class of assets, or some other basis.

5.9 A financial institution shall disclose the accounting policies for the recognition of revenue and or principal payments received, and accounting policies for revenue due but not received, in respect of impaired assets.

Other

STANDARD

5.10 A financial institution shall disclose the accounting policies for funds under management and other fiduciary activities.

6 FINANCIAL PERFORMANCE

STANDARD

6.1 In addition to the disclosure requirements of FRS-9: *Information to be Disclosed in Financial Statements*, financial institutions shall disclose the categories of revenue and expenses identified in paragraph 6.3 below.

COMMENTARY

6.2 Generally accepted accounting practice governing recognition and hedging should be applied when deciding what should be included in the statement of financial performance or in the notes thereto, and when deciding about allocation of amounts to categories of revenue or expense.

STANDARD

6.3 The following categories and sub-categories of revenue and expense shall be disclosed separately:

(a) interest revenue from:
- **(i) lending other than on impaired assets;**
- **(ii) investment securities;**
- **(iii) other securities;**
- **(iv) impaired assets, showing sub-categories; and**
- **(v) other sources;**

(b) net gains or losses from trading activities showing sub-categories;

(c) net gains or losses on the sale of investment securities;

(d) other operating revenue, showing:
- **(i) lending and credit facility related fee revenue;**
- **(ii) other fee revenue;**

(iii) dividends; and

(iv) other sources;

(e) interest expense relating to each of the different classifications of funding presented in the statement of financial position;

(f) impaired asset expenses, showing:

(i) specific provision expense;

(ii) amounts written off directly to the statement of financial performance;

(iii) write-downs of real estate assets acquired through the enforcement of security;

(iv) write-downs of assets other than real estate assets that have been acquired through the enforcement of security; and

(v) recoveries of provisions and write-offs expensed in previous periods; and

(g) current period expense for general provision.

COMMENTARY

6.4 Disclosure of the principal types of revenue and expenses generated by a financial institution assists users to understand the nature of a financial institution's business and to assess the quality and sustainability of its earnings.

6.5 Financial institutions may use different methods for allocating revenues and expenses among the various categories described in paragraph 6.3. For example, profits (losses) on the trading of debt instruments can be fully allocated to gains (losses) from trading activities. Alternatively, those profits (losses) can be split into a "time value of money" component, and a true trading gain (loss) component, and allocated separately to the interest revenue (expense) and trading gains (losses) categories. Similar alternatives are available for the disclosure of foreign exchange trading gains or losses, gains or losses on the trading of derivative products, and gains or losses arising on hedging instruments. Financial institutions should disclose the amounts allocated to the different revenue/expense categories presented in the statement of financial performance.

6.6 For the purposes of the application of FRS-9: *Information to be Disclosed in Financial Statements* to financial institutions, in the case of each of items (a) to (d)(iv) listed in paragraph 6.3 above, operating revenue means the net gain (loss) positions identified by a financial institution on a daily basis.

7 FINANCIAL POSITION

Assets

STANDARD

7.1 A financial institution shall disclose separately classes of recognised financial assets, in the broad order of their liquidity, and shall, as a minimum,

disclose:

(a) cash and demand balances with central banks;

(b) balances with other financial institutions which may be withdrawn without prior notice;

(c) other securities separately showing securities which are eligible for refinancing by central banks and securities held for liquidity and other purposes;

(d) investment securities;

(e) acceptances in respect of bills accepted but not held in a portfolio;

(f) loans, advances and lease finance; and

(g) other assets including a description of the nature and characteristics of those assets.

7.2 Each of the classes of assets listed in paragraph 7.1 shall be shown net of specific provisions. General provisions shall be disclosed separately.

7.3 A financial institution shall disclose the amount of any reclassifications of securities between investment and other securities classes, and the impact that those reclassifications have had on surplus (deficit) before taxation, and the valuations of those securities, as recorded in the statement of financial position.

7.4 Gains or losses that are recognised in respect of unrecognised assets or unrecognised liabilities are to be included within the class of other assets or other liabilities.

COMMENTARY

7.5 Financial assets comprise the majority of a financial institution's total assets by value and warrant more detailed disclosure than is appropriate for entities other than financial institutions. The classifications above represent minimum disclosures. Generally it will be appropriate for more detailed disclosures on the composition of the classes of financial assets to be made in the notes to the financial statements. This provides a more complete picture of the nature, characteristics and purpose of the different financial instruments included in each class of financial asset.

7.6 It is often not possible to draw precise boundaries or to distinguish different purposes between different classes of financial instruments. Accordingly, the categorisations should be supplemented with narrative which explains the classification adopted.

Liabilities

STANDARD

7.7 The recognised financial liabilities of a financial institution shall be disclosed, in broad order of their maturity, distinguishing among liabilities on demand, other short term liabilities and long term liabilities.

7.8 A financial institution shall disclose information on the nature and amount of each class of financial liability where these classifications are based on the priority of creditors' claims over the financial institution's assets in a winding up.

COMMENTARY

7.9 The most useful approach to disclosing a financial institution's recognised financial liabilities is to group them by their nature and to list them in the approximate order of their maturity.

7.10 Disclosure of the priority of financial liabilities provides important information to creditors on the degrees of protection provided to them in the event of the financial institution being wound up. To assess the extent of protection provided, creditors need to be aware of the relative priority of liabilities issued and material terms and conditions which could result in relative positions changing.

7.11 The nature of the various classes of financial liabilities, including the material terms and conditions which attach to them, are also important to users in assessing the relative costs of different financial liabilities and the overall cost of a financial institution's funding strategy.

7.12 Disclosure of the terms and conditions attaching to different classes of financial liabilities enables users to understand better the nature of those financial liabilities. For many entities, the common disclosure requirements set out in FRS-9: *Information to be Disclosed in Financial Statements* will be sufficient. However, where complex financial instruments have been issued by financial institutions, it will often be necessary to disclose additional information. Examples of the types of terms and conditions which may be relevant to users include:

(a) the principal, stated, face or other similar amount;

(b) the date of maturity, expiry or execution;

(c) redemption options held by either party to the instrument, including the period during which, or date at which, the options may be exercised and the redemption price or range of prices;

(d) options of either party to the instrument to convert the instrument into, or exchange it for, another financial instrument or some other liability, including the period in which, or date at which, the options may be exercised and the conversion or exchange ratio(s);

(e) scheduled future cash receipts or payments of the principal amount of the instrument, including instalment repayments and any sinking fund or similar requirements;

(f) stated rate or amount of interest, dividend or other periodic return on principal;

(g) collateral pledged; and

(h) in the case of an instrument that provides for an exchange, information described in items (a) to (g) for the instrument to be acquired in the exchange.

8 UNRECOGNISED FINANCIAL ASSETS, FINANCIAL LIABILITIES AND COMMODITY INSTRUMENTS

STANDARD

8.1 A financial institution shall disclose:

(a) the nature and face or contract amount of each class of unrecognised financial assets, financial liabilities, or commodity instruments; and

(b) the nature, and where quantifiable, the amount of each class of unrecognised financial assets, financial liabilities, or commodity instruments arising from contracts for which there is no face or contract amount.

COMMENTARY

8.2 Many financial institutions are involved in activities that do not give rise to assets or liabilities which are recognised in the statement of financial position. These unrecognised assets and liabilities often represent an important part of the business of a financial institution and may have a significant bearing on the level of credit, market, liquidity and operating risk to which a financial institution is exposed. These items may also increase or decrease other risks. Examples of different classes of unrecognised assets and liabilities include:

(a) direct credit substitutes, including guarantees, bills of exchange, indemnities and other similar facilities;

(b) transaction-related contingencies including performance bonds, bid bonds, warranties and stand-by letters of credit;

(c) short term self-liquidating trade financing transactions which are secured against a shipment of goods;

(d) sale and repurchase agreements and asset sales with recourse not recognised in the statement of financial position;

(e) interest, foreign exchange rate and commodity price-related contracts including forwards, futures, swaps and options;

(f) commitments, including:

  (i) commitments to purchase assets or place deposits which represent commitments with certain drawdowns and commitments for partly-paid shares or securities;

  (ii) commitments to provide financial services with an original maturity of one year or more; and

  (iii) commitments with an original maturity of less than one year or which can be unconditionally cancelled at any time; and

(g) note-issuance facilities and revolving underwriting facilities.

8.3 Disclosure of unrecognised assets and liabilities provides a useful basis for assessing the volumes and types of business a financial institution has in unrecognised contracts. For purposes of disclosure, unrecognised financial assets and liabilities are to be offset only if the criteria for offsetting recognised items, discussed in FRS-27: *Right of Set-off*, are met.

9 DISCLOSURES CONCERNING FAIR VALUE

STANDARD

9.1 The fair value of each class of financial and commodity assets and liabilities, whether recognised or unrecognised, together with their financial report carrying amounts, shall be disclosed, unless it is not practicable to estimate that value with an acceptable level of reliability within constraints of timeliness and cost. When the fair value of any financial or commodity assets or liabilities cannot be estimated, this fact shall be disclosed together with information about the principal characteristics of the instruments that are pertinent to their value.

COMMENTARY

9.2 Current value information provides a useful measurement of unrecognised financial or commodity instruments and a useful additional measurement of recognised instruments that are carried on a cost or amortised cost basis. It is particularly useful when viewed in conjunction with financial report carrying amounts. Comparisons of the fair value and the carrying amount provide information about unrealised gains and losses not recognised in the financial reports. Information about current market values of liabilities as well as assets may be particularly relevant to an evaluation of the performance of a financial institution in structuring its portfolio to match changes in the value of assets with corresponding changes in the value of liabilities.

9.3 When a financial or commodity asset or liability is traded in an organised and liquid market that is able to absorb a significant transaction without moving the price against the trader, quoted market prices would be used to measure fair value. When quoted market prices are not available, techniques for estimating fair value, such as discounting estimated future cash flows at a current market rate commensurate with the risks involved, are to be used. In some cases, estimation of fair value may not be practicable within acceptable levels of reliability and at a reasonable cost. For example, the cost of making a reasonably reliable estimate of the fair value of the loan portfolio of a financial institution may be excessive in relation to the perceived benefits to users. In such situations, disclosure of fair value information may be omitted with an explanation of the reason for the omission and additional information about the principal characteristics of the

instruments that are pertinent to their value. The latter information may assist users of the financial reports in making their own judgements about the likely significance of any difference between fair value and the carrying amount.

10 ASSET QUALITY

STANDARD

10.1 In respect of each of the following classes of assets:

(a) non-accrual assets;

(b) restructured assets;

(c) real estate assets acquired through the enforcement of security;

(d) other assets acquired through the enforcement of security; and

(e) past-due assets;

a financial institution shall disclose the following information:

(i) the aggregate amount of recognised assets before deducting provisions for expected losses or diminution in asset value;

(ii) the aggregate amount of unrecognised assets before deducting provisions for expected losses or diminution in asset value; and

(iii) the aggregate amount of provisions for expected losses or diminution in asset value.

10.2 A financial institution shall disclose the movements from one reporting period to the next in each of the pre-provision balances required to be disclosed in paragraphs 10.1(a) to (e).

COMMENTARY

10.3 The requirement for financial institutions to disclose movements, between reporting periods, in balances of past-due assets and each class of impaired assets, enables users of financial statements to assess, trends in asset quality. For example, disclosure of movements in non-accrual asset balances might include, for both recognised and unrecognised exposures:

Balance at the beginning of the period

Additions to non-accrual status

Amounts written off

Deletions from non-accrual status

Balance at the end of the period.

Financial institutions should disclose further details on other movements in impaired asset and past-due asset balances if those movements are material.

STANDARD

10.4 A financial institution shall provide information on the balances of, and movements in, total specific and general provisions from one reporting period to the next, with movements reconciled to expenses recognised in the statement of financial performance. This information shall include disclosure of movements in provisions for each of the asset classes set out in paragraphs 10.1(a) to (e).

COMMENTARY

10.5 Financial institutions suffer losses, or a deterioration in the value of some loans, advances, or other credit exposures. Users of financial statements need to know the impact that losses or expected losses have or may have on financial position, financial performance, and cash flows. This information assists users in assessing the effectiveness with which the financial institution has employed its resources, and promotes confidence in the adequacy of the measurement of the quantity and quality of a financial institution's equity. Critical to this disclosure is a meaningful description of how impaired assets are recognised, classified and managed.

10.6 A financial institution is required to disclose the amount of its past-due assets and the amount of each class of impaired assets, before and after deducting provisions for expected losses or diminution of value. These assets are defined on an all-encompassing basis and include both recognised and unrecognised credit exposures. For instance, if a financial institution incurs, or expects to incur, a loss on credit exposures such as guarantees of indebtedness, standby letters of credit, and foreign exchange, interest rate and other market related contracts, then these credit exposures should also be included in the disclosure of non-accrual assets.

11 MANAGEMENT OF LIQUIDITY

STANDARD

11.1 A financial institution shall disclose its policies for managing liquidity, and quantify its liquidity position. The disclosures shall explain the characteristics of the financial institution's recognised assets and liabilities for which disclosure is required in paragraphs 7.1 to 7.4, and 7.7 to 7.8, and any support arrangements such as standby credit lines, from the perspective of its ability to meet its obligations as they fall due.

COMMENTARY

11.2 Many financial institutions take short term deposits, including customer transactions balances, and lend for longer periods. For this financial structure to be viable, a high level of confidence must be maintained that the financial institution's short term deposits will be maintained or renewed at maturity. Stocks of liquid assets, support arrangements, and unrecognised items can affect a financial institution's ability to meet obligations as they fall due.

11.3 The matching and controlled mismatching of the maturities of assets and liabilities is important to the management of a financial institution. One approach to disclosing information which is relevant for the assessment of a financial institution's liquidity position is to disclose an analysis of assets and liabilities, including unrecognised assets and liabilities, into relevant maturity groupings based on the remaining period to maturity at a particular reporting date. Such an analysis can be presented on the basis of either contractual maturity dates for assets and liabilities, or estimated maturity dates for liabilities and potential or expected realisation dates for assets. Another approach would be to refer to the order of liquidity in the statement of financial position and to supplement this with information on standby facilities and liquidity management policies.

11.4 Whichever method is used to quantify the financial institution's liquidity position, disclosure should be supplemented by a discussion of the effects of the assumptions used and the basis for those assumptions.

12 DISCLOSURES CONCERNING EXPOSURE TO CURRENCY AND INTEREST RATE RISK

STANDARD

12.1 A financial institution shall disclose:

(a) its policies for managing currency risk; and

(b) for each class of financial asset and liability, whether recognised or unrecognised, quantitative information about its exposure to currency risk.

12.2 A financial institution shall disclose:

(a) its policies for managing interest rate risk; and

(b) for each class of financial asset and liability, quantitative information about its exposure to interest rate risk, including information about:

(i) effective interest rates; and

(ii) contractual repricing or expected maturity periods, whichever periods are earlier.

COMMENTARY

12.3 The disclosure of information on management policies should include the following:

(a) an explanation of currency and interest rate risk;

(b) the nature of the financial institution's activities which give rise to currency risk and interest rate risk;

(c) the methods used to monitor exposure to currency risk and interest rate risk, including the frequency with which exposures are monitored;

(d) the systems and procedures for controlling currency risk and interest rate risk, including whether exposure limits are employed.

This information should assist users to understand the nature of the positions adopted.

12.4 A financial institution's exposure to currency risk can be disclosed in a number of ways. This could include disclosure of the financial institution's net open position in each currency, using the local currency value of the net financial assets held in that foreign currency, for both recognised and unrecognised financial instruments. This should enable users of financial reports to compare exposure to currency risk between separate financial reporting periods, and to make comparisons between financial institutions.

12.5 Information about effective interest rates and expected repricing or maturity dates indicates the length of time for which interest rates are fixed at present levels. This is important because it provides a basis for evaluating the interest rate risk to which an entity is exposed. Interest rate risk increases if there is a mis-match between the repricing of financial assets and financial liabilities. A repricing schedule increases the understanding of interest rate risk because it compares the maturity or repricing of financial assets and financial liabilities over common future periods.

12.6 The effective interest rate (effective yield) of a monetary financial instrument is the rate that, when used in a present value calculation, results in the carrying amount of the instrument. The present value calculation applies the interest rate to the stream of future cash receipts or payments from the reporting date to the next repricing (maturity) date and to the expected carrying amount (principal amount) at that date. The rate is an historical rate for a fixed-rate instrument carried at amortised cost and a current rate for a floating-rate instrument or an instrument carried at net fair value. The effective interest rate is sometimes termed the level yield to maturity or to the next repricing date, and is the internal rate of return of the instrument for that period.

12.7 A financial institution should disclose its effective interest rates for different classes of financial assets and liabilities. In providing this disclosure, a financial institution should group instruments denominated in different currencies or having substantially different credit risks into separate classes when these factors result in instruments having substantially different effective interest rates.

12.8 The requirement to disclose effective interest rates applies to monetary financial instruments involving future payments that create a return to the holder and a cost to the issuer reflecting the time value of money. The requirement will not apply to financial instruments that do not bear a determinable effective interest rate. While instruments such as interest rate derivatives, including swaps, forward rate agreements and options, are exposed to price or cash flow risk from changes in market interest rates, disclosure of an effective interest rate is not relevant.

12.9 How a financial institution should provide effective interest rate information depends on the nature of approach taken by the financial institution towards the

management of its interest rate risk. When, in the normal course of the financial institution's management of its interest rate risk, hedging or conversion transactions have been undertaken for the purpose of managing effective interest rates on financial instruments comprising, or contained within, particular classes of financial assets and liabilities, the effective interest rates of the financial instruments concerned should be disclosed inclusive of the impact on those rates of the hedging or conversion transactions so allocated. When effective interest rates have been disclosed in this manner, to ensure that readers are provided with information on exposure to basis risk, the financial assets and liabilities comprising the hedged or converted positions should not incorporate values of the hedging or conversion transactions (unless exposure to basis risk is immaterial). A narrative should be added to the disclosures to explain this difference in the manner in which the effective interest rates have been determined and the manner in which information has been presented. When hedging or conversion transactions have not been allocated to particular classes of financial assets and liabilities, the effective interest rates of recognised financial assets and liabilities concerned should be disclosed exclusive of the impact of the hedging or conversion transactions.

13 DISCLOSURES CONCERNING CREDIT EXPOSURE

STANDARD

13.1 For each class of recognised or unrecognised asset that gives rise to credit risk, a financial institution shall disclose information about its exposure to credit risk, including:

(a) the amount that best represents its maximum credit exposure; and

(b) a brief description of any collateral or other similar credit risk support arrangements held in support of its credit exposures.

COMMENTARY

13.2 The amount of the loss that would be incurred if the counterparty to a financial instrument failed to perform its obligations and any collateral held proved to be valueless provides a measure of the maximum possible credit loss. For a recognised financial instrument (for example, a non-interest bearing trade account receivable) the carrying amount in the statement of financial position is the maximum possible credit loss. The caption used to describe such financial instruments implies the existence of credit risk. For some financial instruments, however, the maximum loss may exceed the recognised amount, perhaps by a significant margin. Loan commitments and financial guarantees are examples of unrecognised financial instruments with significant risk. While it is not expected that an entity will incur the maximum possible credit loss for unrecognised financial instruments, disclosure of this amount provides important information for analysis that is not otherwise available within the statement of financial position.

13.3 For financial institutions, disclosures of recognised assets and the credit equivalent amounts of unrecognised assets calculated for capital adequacy purposes appropriately classified may best represent the financial institution's maximum exposure to credit risk.

STANDARD

13.4 A financial institution shall disclose the amounts of concentrations of credit exposure. Such disclosures shall be made in terms of:

(a) customer industry or economic sectors, and

(b) geographical areas, showing, where applicable, the following concentrations:

- **(i) credit exposure concentrations within New Zealand; and**
- **(ii) credit exposure concentrations to other countries, showing the amount of credit exposure to each country.**

COMMENTARY

13.5 A financial institution should disclose the amounts of any material concentrations of credit exposure because such information provides a useful indication of the credit risks inherent in the business of the financial institution.

13.6 Such disclosures should be made in terms of geographical areas and customer industry or economic sectors which are appropriate in the circumstances of the financial institution. Relevant geographical concentrations may be national, regional, or even municipal in nature, depending on the configuration of an individual institution's portfolio of credit exposures. Similarly, it is not possible to prescribe precise disclosure requirements with respect to customer industry sectors, since there are different ways to define those sectors, and the boundaries between them are not always clear. One method is to use codes adopted for official statistical reporting purposes, such as the Australian and New Zealand Standard Industrial Classification (ANZSIC). Financial institutions should disclose the methods used.

13.7 For financial institutions, disclosure of recognised assets and the credit equivalent amount of unrecognised assets calculated for capital adequacy purposes appropriately classified may best represent the financial institution's geographical or industrial credit exposure concentrations.

13.8 Concentrations of credit risk to individual counterparties and related parties are aspects of credit concentration which warrant special treatment, and are dealt with separately in paragraphs 13.11 to 13.14 and SSAP-22: *Related Party Disclosures* respectively.

STANDARD

13.9 A financial institution shall disclose its credit risk management policies, including policies with respect to requiring collateral or other security to

support credit exposures, and the entity's access to that collateral or other security.

COMMENTARY

13.10 Disclosure about a financial institution's requirements with respect to taking collateral or other security to manage the credit risk associated with financial instruments is useful because knowledge of those arrangements assists in the assessment of overall asset quality. Examples of policies about which information is usefully disclosed, depending on the nature of a financial institution's business, include requirements with respect to loan to security ratios, and policies on the different types of security required to be taken in order to mitigate credit risks assumed in the personal, commercial and corporate business sectors, and where applicable, the inter-financial institutional sector.

STANDARD

13.11 A financial institution shall disclose the number of individual counterparties (not being members of a group of closely related counterparties) and groups of closely related counterparties to which the financial institution has a credit exposure (net of specific provisions) which equals or exceeds 10% of equity, in successive ranges of 10% of equity, commencing at 10% of equity.

13.12 Where the entity reporting is a New Zealand branch of an overseas incorporated financial institution, the disclosures required under paragraph 13.11 shall be made by relating credit exposure recorded in the books of the branch to the latest published global equity position of the financial institution.

13.13 Branches of overseas incorporated financial institutions shall disclose:

(a) whether there are any legal, regulatory or other impediments that restrict the rights of New Zealand creditors with respect to their claims over the proceeds of sale of the assets of the global financial institution and, if so, the nature of those impediments; and

(b) that credit exposures to individual counterparties (not being members of a group of closely related counterparties) and to groups of closely related counterparties do not include exposures to those counterparties if they are booked outside New Zealand.

COMMENTARY

13.14 It is useful for financial institutions to disclose information about collateral, and guarantees or indemnities given in support of credit exposures, as they may affect the amount of eventual loss.

13.15 To determine when counterparties are related it is appropriate to follow the control and significant influence criteria outlined in SSAP-8: *Accounting for*

Business Combinations. The financial soundness of one party may affect the financial soundness of another where the financial exposure of one to the other is large in relation to its own net assets. Generally, the exposed party will have entered into arrangements under which it can exercise significant influence over the other party to protect its exposure.

13.16 The credit risk associated with an individual customer relates to a number of factors, including the amount and term of the exposure, and the credit standing of the customer. In line with FRS-27: *Right of Set-off*, this standard does not regard credit risk lay-off arrangements as reducing the amount of exposure held with the original borrower. Accordingly, a credit exposure supported by a guarantee or similar support arrangement should be treated as a credit exposure to the original borrower, and not as a credit exposure to the guarantor. Disclosure of information on the nature and extent of such support arrangements may facilitate understanding of an institution's exposure to credit risk. Matters on which general commentary would also be useful may include priorities on a winding up, and the credit standing of customers.

13.17 Disclosure of a financial institution's concentration of credit exposure to individual counterparties is required to be made on the basis of the reporting entity's equity. The concentration of credit exposures to individual counterparties booked in the New Zealand branches of overseas incorporated financial institutions should be disclosed on the basis of the latest available published global equity position of the financial institution. Disclosures on this basis for New Zealand branches are appropriate because the global equity of the overseas incorporated financial institution is generally available to absorb losses arising from credit exposures in the New Zealand branch. Where there are impediments that restrict the rights of New Zealand creditors with respect to their claims over the assets of the global financial institution, these are required to be disclosed. For example, disclosure is required of the existence of and nature of any legislative or regulatory restrictions which subordinate the claims of any class of unsecured creditors of a New Zealand branch on the assets of the global financial institution in a winding up of that global financial institution. New Zealand branches are also required to disclose that the overseas incorporated entity may have exposures to individual counterparties booked outside New Zealand.

14 CONCENTRATIONS OF FUNDING

STANDARD

14.1 A financial institution shall disclose the amounts of concentrations of funding. Such disclosure shall be made in terms of:

(a) customer industry or economic sector;

(b) geographical funding concentrations, showing, where applicable, the following concentrations:

(i) concentrations of funding within New Zealand; and

(ii) concentrations of funding from other countries, showing the amount of funding from each country; and

(c) product.

COMMENTARY

14.2 A financial institution should disclose material concentrations in the distribution of its sources of funding because such information is a useful indication of the reliance which the financial institution has placed on a particular source for funds.

14.3 Paragraph 14.1 requirements are minimum disclosure requirements, and do not preclude additional disclosures being made about other sources of funding where that information is relevant to users understanding the stability of funding sources, or a financial institution's exposure to changes in funding costs.

14.4 Disclosures of the amount of funding booked in different legal jurisdictions promote understanding about the exposure of a financial institution to financial dislocations of a systemic nature originating either in overseas countries or domestically.

14.5 Funding obtained from related parties, such as a parent bank, is a particular funding class which is required to be disclosed separately in accordance with the requirements of SSAP-22: *Related Party Disclosures*.

15 MANAGED FUND, SECURITISATION, CUSTODIAL, AND OTHER FIDUCIARY ACTIVITIES

STANDARD

15.1 A financial institution shall disclose the nature of its involvement in funds management, securitisation, custodial, and trust activities and the nature of those arrangements which exist to separate the business risk of such activities from that of its other activities. A financial institution shall also disclose the amount of its involvement in funds management, securitisation, and trust activities, and, where possible, its custodial activities.

COMMENTARY

15.2 Besides financial intermediation or dealing activities, many financial institutions are involved in providing trustee, custodial, investment advisory or investment management services. Investment management may involve the management of schemes sponsored by other institutions, or established by a member of the financial institution's group, either on a collective or an individual basis. Financial institutions may also be involved in the origination of securitised assets and the marketing or servicing of securitisation schemes. If the business risk

relating to such fiduciary activities is not isolated from other activities of the entity, the financial performance and position of the other activities may be adversely impacted as a consequence.

16 TRANSITIONAL PROVISION

STANDARD

16.1 Comparative figures are not required to be presented in the first period of application of this Standard for items not previously disclosed in the financial institution's general purpose financial statements of the prior period.

APPENDIX

Comparison of FRS-33 With International and Australian Accounting Standards

This comparison appendix was prepared as at 1 March 1997 and deals only with significant differences among the standards. It is produced for information purposes only and does not form part of the standards in FRS-33. The International standards referred to in this appendix are promulgated by the International Accounting Standards Committee.

The International and Australian financial reporting standards comparable with FRS-33 are:

- IAS-30 (1990*): Disclosures in the Financial Statements of Banks and Similar Financial Institutions*; and
- AAS-32 (1996): *Specific Disclosures by Financial Institutions*.

FRS-33 incorporates the disclosure requirements of FRS-33: *Disclosure of Information about Financial Instruments*, as they relate to financial institutions. In Australia these disclosures are separately contained in AAS-33: *Presentation and Disclosure of Financial Instruments*. Similarly, the IASC has these disclosures separately contained in IAS-32: *Financial Instruments: Disclosure and Presentation*.

There is substantial agreement among these standards and FRS-33. The following summarises the significant differences between FRS-33, AAS-32, and IAS-30.

Definitions

FRS-33 and AAS-32 have similar definitions of financial institution. Both exclude intra-group finance entities from this definition. However, while AAS-32 excludes entities principally funded within a group, FRS-33 excludes only entities which are wholly funded within a group and which do not engage in activities giving rise to unrecognised financial liabilities. The corresponding definition in IAS-30 does not exclude intra-group finance entities.

AAS-32 defines general and specific provision in terms of “probable diminution in value”. No measure of probability is assigned in FRS-33. “Provision” is undefined in IAS-30.

Volume/Rate Analysis

AAS-32 requires average balances and average interest rates for each major category of interest-bearing asset and liability. These disclosures are not required by FRS-33 and IAS-30.

Interest Forgone

AAS-32 requires the disclosure of interest forgone. This disclosure is not required by FRS-33 and IAS-30.

Maturity Analysis of Assets and Liabilities

Both AAS-32 and IAS-30 require a maturity analysis of assets and liabilities. FRS-33 allows flexibility in the presentation of this information.

Disclosures Concerning Credit Exposure

FRS-33 contains additional disclosure requirements with regard to New Zealand branches of overseas incorporated financial institutions.

Concentrations of Funding

FRS-33 is more specific than AAS-32 and IAS-30 with regard to disclosures of funding concentrations, requiring an analysis by customer industry or economic sector, geography, and product.

Managed Fund and Other Fiduciary Activities

FRS-33 is more specific than AAS-32 and IAS-30 with regard to disclosures concerning fiduciary activities. FRS-33 requires disclosure of the nature of the arrangements which exist to separate the business risk of managed activities from that of its other activities. AAS-32 only requires general disclosure of the nature and extent of fiduciary activities undertaken. IAS-30 requires similar general disclosure only when the entity is involved in significant trust activities.

Illustrative Example

AAS-32 provides illustrative examples of disclosure requirements. Illustrative examples are not provided in FRS-33 and IAS-30.

HISTORY

No previously issued accounting standards are superseded by this Financial Reporting Standard.

FRS-33