



QUEENSLAND TREASURY

2020-21 FINANCIAL REPORTING REQUIREMENTS

FOR QUEENSLAND GOVERNMENT AGENCIES

FRR 4E Financial Instruments

INTRODUCTION

Policy items, indicated by **shaded bold print**, form the Minimum Reporting Requirements (MRRs).

Pursuant to sections 38(2) and 39(2) of the *Financial and Performance Management Standard 2019* (FPMS), departments and statutory bodies must prepare their financial statements in accordance with the MRRs. All of the MRRs are mandatory for departments. Statutory bodies comply with the FPMS by applying the parts of the MRRs that are considered relevant to their circumstances.

Application Guidance, indicated by plain text under the "Application Guidance" sub-headings, provides support on interpreting and applying the mandatory policy items and other matters.

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4E.1 FINANCIAL INSTRUMENTS – CLASSIFICATION AND MEASUREMENT

REFERENCES

- AASB 7 *Financial Instruments: Disclosures*
- AASB 9 *Financial Instruments*
- AASB 13 *Fair Value Measurement*
- AASB 101 *Presentation of Financial Statements*
- AASB 132 *Financial Instruments: Presentation*
- Interpretation 16 *Hedges of a Net Investment in a Foreign Operation*

APPLICATION GUIDANCE

A financial instrument is defined in AASB 132, and include items such as cash, trade receivables and payables, loans, bonds, equity investments, derivatives, and others. Some items like prepayments and unearned revenue are not financial instruments because they are settled by receipt/delivery of goods or services rather than with cash or another financial asset.

The initial recognition and measurement requirements of AASB 9 do apply to statutory receivables (but not statutory payables). Otherwise, agencies should take note of the types of financial instruments excluded from the scope of the three standards – AASB 7, AASB 9 and AASB 132. Exclusions include interests in subsidiaries, associates and joint ventures, employee benefits, insurance contracts, amongst others.

Statutory receivables are deemed financial assets under AASB 9

AASB 9 Appendix C contains guidance about statutory receivables, specifically on the timing of recognition. An agency recognises a statutory receivable and corresponding revenue when the statutory requirements establishes a right for the agency to receive cash or another financial asset. Such a right arises on the occurrence of a past event, for example:

- Land tax – passing of the relevant land tax assessment time/date;

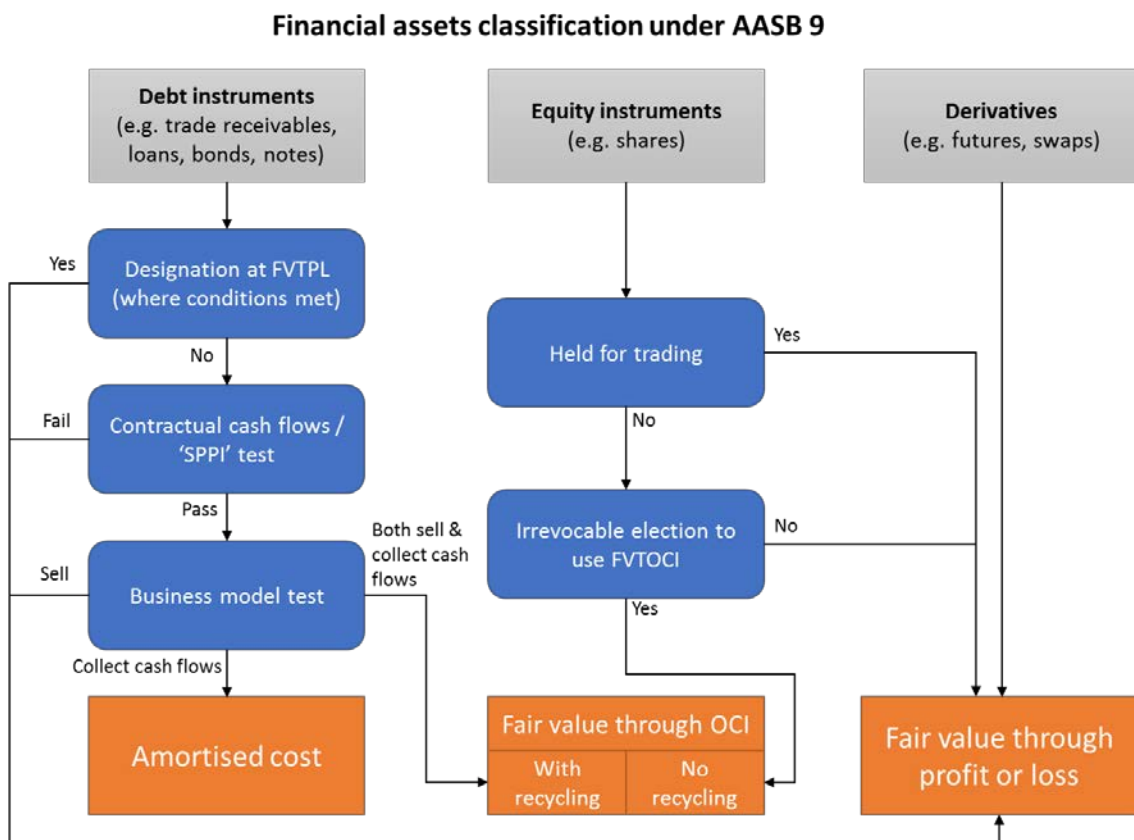
- Fines and penalties – when the fine is issued;
- Payroll tax – end of each payroll tax return period;
- Transfer duty – date of dutiable transfer.

Paragraph C7 states that in some instances the receivable arising from taxable events cannot be measured reliably until a later reporting period. For example, in rare circumstances, the amount may not be measurable until all the relevant information has been produced and certified. In such cases, the receivable (and revenue) would only be recognised once the amount can be measured reliably. However, if the amount of the revenue is capable of estimation but will not billed/levied until after year-end, an accrual of revenue may be required at the reporting date.

Agencies are also to use the impairment principles of AASB 9 to calculate the loss allowance for statutory receivables. FRR 4E.2 discusses impairment in more detail. For departments, statutory receivables and revenue will also need to be properly classified into controlled and administered items in accordance with FRR 2E.

Classification of financial assets

Financial assets are classified into one of three underlying measurement bases – amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). The classification criteria are outlined in the following flowchart:



However, within the FVOCI category, debt instruments and equity instruments have differing accounting treatments, summarised in the following table:

Table: Accounting Treatment for Debt and Equity Instruments at FVOCI

	Debt instruments at FVOCI (para 4.1.2A)	Equity instruments at FVOCI (para 5.7.5)
Recycling of fair value gains or losses to P/L when the asset is derecognised	Recycling	No recycling
Effective interest method	Applies	Not applicable
Impairment	Applies	Not applicable

Key tests for measuring financial asset debt instruments

For debt instruments, such as trade receivables and loans receivables, that are not designated at FVTPL by the entity, there are two key tests to be applied to determine the correct measurement basis.

1. The **contractual cash flows test (“SPPI test”)**.

This test assesses whether the contractual terms of the financial asset give rise on specific dates to cash flows that are **solely payments of principal and interest** (SPPI) on the principal amount outstanding. For the purposes of considering whether interest meets this test, the most significant elements of interest within a basic lending arrangement are typically the consideration for the time value of money and credit risk. Consideration may also include compensation for other basic lending risks (e.g. administrative costs).

However, if the contractual cash flows include consideration for aspects other than the basic lending risks and costs (e.g. exposure to equity returns, commodity prices, etc.) this test is failed and the financial asset must be measured at FVTPL. If the cash flows are solely payments of principal and interest, the agency then applies the second test (the business model test).

2. The **business model test**.

This test assesses the objective of the business model within which the financial asset is held to determine the classification of financial assets that meet the contractual cash flows test.

- If the business model objective is to hold financial assets in order to **collect contractual cash flows**, and the SPPI test is met, the financial asset is measured at amortised cost.

- If the business model objective is achieved by both **collecting contractual cash flows and selling financial assets**, and the SPPI test is met, the financial asset is measured at FVTOCI. Gains and losses recognised in OCI are reclassified ('recycled') to profit or loss upon derecognition.
- If another business model objective is used (i.e. a business model other than the two specified above) the financial asset is measured at FVTPL. An example of this is where the business model objective is the realisation of cash flows through the sale of financial assets.

Despite the new criteria, an agency may, at initial recognition, irrevocably designate a financial asset at fair value through profit or loss if this would eliminate or significantly reduce a measurement or recognition inconsistency (an accounting mismatch) that would otherwise result from measuring related assets and liabilities, or gains and losses on them, on different bases. For more guidance, see AASB 9 paragraphs B4.1.27-B.4.1.32.

Concessional interest and interest-free loans

These loans are often provided with the intent of providing a benefit (the concessional component) to the borrower. When initially measuring the loan receivable at fair value, the agency should use an observable market interest rate for a loan of a similar amount, duration and security. For example:

- if the loan is secured by real estate, the agency can look at prevailing mortgage rates,
- if the loan is to an individual and is unsecured, the agency can look at unsecured personal loan rates.

As the market rate is higher than the concessional rate offered in the loan, the loan's initial fair value will be less than the cash advanced. The difference is to be recognised as an expense in accordance with paragraphs 5.1.1A and B5.1.2A, and it will typically be classified as a grant expense. With the concessional component separated out as an expense, the remaining financial asset will likely meet the criteria for amortised cost.

Originated credit-impaired loans

A concessional loan (or portfolio of loans) may, in certain instances, have the same or similar characteristics to a originated credit-impaired loan. E.g. issuing loans to a sector of the economy or community facing hardship where it is expected, at the outset, that not all borrowers will be able to repay all of their commitments. In such cases, the finance provided

may be an in-substance grant provided to the borrower and the entire difference between the loan's fair value and the cash advanced should be treated as a grant expense on initial recognition, rather than as a credit loss.

Originated credit-impaired loans have different interest revenue recognition requirements – refer to paragraphs 5.4.1(a) and B5.4.7. Where such loans are measured subsequently at amortised cost, repayments of principal that exceed the initial fair value measurement of the loan would be credited to the operating statement as an impairment gain (paragraph 5.5.14).

Contingently Repayable Loans

Agencies need to consider the contractual conditions that determine or trigger the contingent payments. Where there is exposure to risks/variables other than those expected in a basic lending arrangement (time value of money and credit risk), the loan is unlikely to meet the SPPI test, and will therefore be measured at FVTPL.

For example, if a loan is repayable upon the borrower company achieving financial success with a product, then it is contingent on a variable other than time value of money or credit risk. The loan will therefore need to be measured at FVTPL.

Unquoted equity instruments

All investments in equity instruments that are within the scope of AASB 9 and contracts on those instruments will need to be recognised at fair value, as they will not satisfy the SPPI test. Unquoted equity instruments can no longer be measured at cost. Due to this change, agencies may find it useful to refer to an education paper issued by the International Financial Reporting Standards (IFRS) Foundation, titled *IFRS 13 Fair Value Measurement - Unquoted equity instruments within the scope of IFRS 9 Financial Instruments* – <http://archive.ifrs.org/Use-around-the-world/Education/FVM/Documents/Education-guidance-FVM.pdf>

Agencies are permitted to make the election in AASB 9 paragraph 5.7.5 to measure equity instruments that are not held for trading at FVOCI instead of FVTPL. Unlike debt instruments measured at FVOCI, the gains and losses recognised in OCI are not reclassified/recycled to profit or loss when the equity instrument is derecognised. Also, agencies should note that additional disclosures are required for equity instruments held at FVOCI.

4E.2 FINANCIAL INSTRUMENTS – IMPAIRMENT

REFERENCES

- *AASB 9 Financial Instruments*
- *AASB 101 Presentation of Financial Statements*

POLICY

- **Agencies shall use the simplified approach in AASB 9 paragraph 5.5.15 (and therefore always measure lifetime expected credit losses) for all trade receivables and contract assets, including those that contain a significant financing component.**
- **Agencies shall not use the simplified approach in AASB 9 paragraph 5.5.15 for lease receivables.**
- **Departments and statutory bodies consolidated into the whole-of-Government financial statements shall not recognise a loss allowance under AASB 9 for receivables from another Queensland Government agency (including Government-owned Corporations) unless approval has been received from Queensland Treasury.**

APPLICATION GUIDANCE

AASB 9 introduces a new 'expected credit loss' model for determining impairment losses for financial assets. This new impairment model will be based on reasonable and supportable forward-looking information. It differs significantly from the impairment model in AASB 139 which is an 'incurred loss' model that only recognises impairment losses when there is objective evidence of impairment as a result of actual loss events occurring. Under the new model, a loss allowance will need to be recognised for all financial assets (although the amount may be negligible for high credit quality assets). Under AASB 9, impairment losses will be recognised earlier compared to AASB 139.

In addition to financial assets, there are certain assets that do not meet the definition of a financial instrument but to which AASB 9 impairment requirements apply (e.g. contract assets arising from AASB 15).

Impairment of inter-agency receivables

Inter-agency loans and receivables between Departments, Statutory Bodies and Government Owned Corporations are expected to have an insignificant, and therefore immaterial, level of credit risk exposure due to the high credit rating of the State. This conclusion is based upon the historical default rates published by global credit rating agencies periodically (and monitored by Queensland Treasury) relating to the credit rated sovereign debt on issue globally.

Consequently, Queensland Treasury expects that departments and statutory bodies will not measure any loss allowance for receivables collectible from other Queensland Government agencies on the basis that any impairment would be negligible, and therefore immaterial. Agencies are to consult with Treasury before recognising an impairment loss on any inter-agency receivable.

Agencies are responsible for ensuring that internal-to-Government receivables/payables are properly recorded in BOTH AGENCIES financial records for the purpose of accurate elimination for whole-of-Government reporting. There may, from time to time, be disputes around the validity or legitimacy of inter-agency receivables. This might range from whether a debt is owed at all to the amount of the receivable/payable. In these situations, Queensland Treasury does not consider this requires an impairment loss to be recognised within a whole-of-Government context – rather the agencies shall resolve the dispute so the receivable / payable position between the two agencies agrees.

The resolution of the issue may result in the “lending” agency either de-recognising or writing down the carrying amount of the receivable. The adjustment may also involve the full or partial reversal of the original entry recorded. Alternatively, the “borrowing” agency may need to recognise an additional amount payable or settle the outstanding debt owing. The agencies involved should consult with their Treasury Analyst if required to resolve the matter.

Expected credit losses

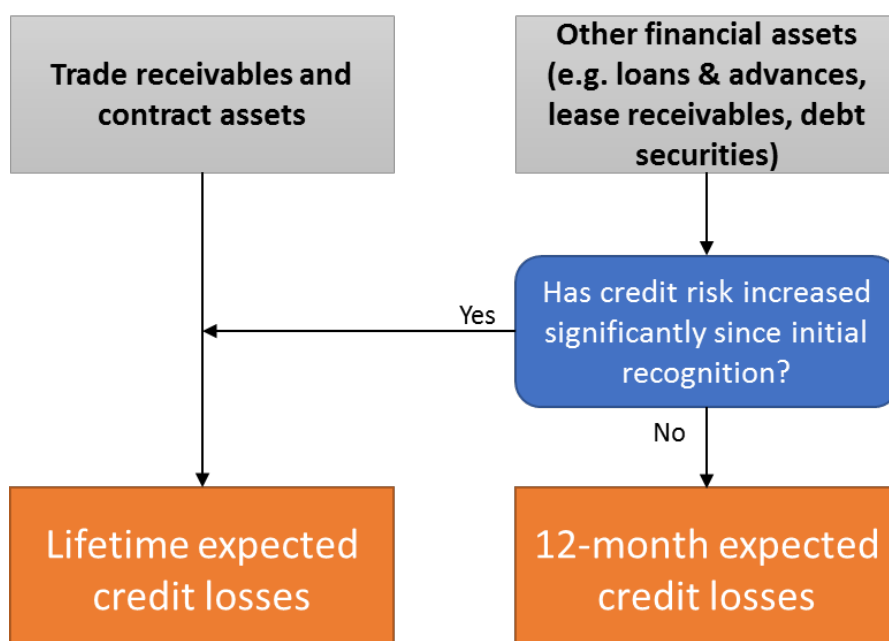
Expected credit losses are a probability weighted estimate of the present value of the difference between the cash flows that are due to the agency and the cash flows the agency expects to receive. A payment that is expected to be received in full, but late, also results in an expected credit loss, because the present values will be different (subject to materiality considerations). When measuring expected credit losses, agencies must also consider amounts expected to be recovered from any collateral, net of costs to obtain and sell the collateral, as this reduces the loss given default percentage. For example, the expected credit loss for a financial asset could be calculated as the amount outstanding (e.g. \$100,000) x probability of default (e.g. 10%) x loss given default (e.g. 80%) = \$8,000.

A key change from AASB 139 is the requirement to consider forward-looking information that is available without undue cost or effort. Agencies will need to apply significant judgement about how expected future changes in macroeconomic factors (e.g. economic growth, unemployment, household debt levels, etc.) will affect their measurement of expected credit losses. For this purpose, economic statistics published by the Queensland Government Statistician's Office may provide a useful basis for making forward looking estimates/judgements.

- <http://www.qgso.qld.gov.au/subjects/economy/index.php>
- <http://www.qgso.qld.gov.au/subjects/economy/labour/reports/reg-labour-force/index.php>
- <http://www.qgso.qld.gov.au/subjects/economy/labour/reports/employment-by-industry/index.php>

Using the QGSO statistics, agencies can perform trend analysis and/or correlate the information against actual defaults experienced by agencies. Known events or conditions pertaining to a specific group of debtors or geographic area must also be taken into account.

The impairment allowance for financial assets is measured at either '12-month expected credit losses' or 'lifetime expected credit losses'. The flowchart below summarises the standard's requirements and Treasury policies.



Estimating expected credit losses for trade receivables

Under AASB 9's expected loss model, it will be insufficient to provide only for debtors that have evidence of impairment. Instead agencies must estimate expected credit losses for each receivable, including those that currently have no indicators of being uncollectible.

The most practical method to calculate expected credit losses for trade receivables will depend on the nature of the agency's portfolio of debtors. Any agency with a small number of debtors may find it more efficient to assess each debtor individually – refer to Example 1 below. Alternatively, agencies with large portfolios can use a provision matrix as a practical expedient – refer to Examples 2 and 3 below.

Example 1 – Assessing trade receivables individually

The table below shows, for illustrative purposes only, example expected credit loss calculations for 8 trade receivables. This approach can be used by smaller agencies with few debtors.

Debtor	Amount outstanding (A)	Probability of default (B)	Loss given default (C)	ECL (A x B x C)	Comments
01	\$1,000	0.1%	100%	\$1	
02	\$4,000	0.1%	100%	\$4	
03	\$15,000	1.0%	20%	\$30	Collateral is expected to cover 80% of the debt
04	\$1,500	5.0%	100%	\$75	Debt is 30 days overdue
05	\$5,000	95.0%	100%	\$4750	Debt is 90+ days overdue and debtor has ceased trading
06	\$10,000	25.0%	0%	\$0	Debt is 90+ days overdue but collateral is expected to exceed the debt
07	\$2,000	2.0%	100%	\$40	Debtor's liquidator advised the expected dividend receivable will be 25% of the debt (i.e.\$500). But there's also a 2% chance we won't receive anything at all. N.B. An alternate calculation for Debtor 07 where there are two possible outcomes would be: (A) \$2,000 x (B) 100% x (C) 75% = \$1,500 plus (A) \$500 x (B) 2% x (C) 100% = \$10 giving the same total ECL of \$1,510.
		98.0%	75%	\$1,470	
08	\$3,000	0.1%	100%	\$3	
	\$41,500			\$6,373	

Total loss allowance is \$6,373, resulting in a net receivables balance of \$35,127.

Agencies with a large number of debtors do not need to assess each debtor individually. Instead, agencies can, as a practical expedient, use a provision matrix. A provision matrix assigns expected loss percentages to different aging bands of receivables to estimate the expected credit loss for the whole portfolio. The percentages are calculated based on historical credit loss experience, adjusted by current conditions and forward-looking data.

Agencies will also need to consider whether certain groups of debtors exhibit different loss patterns and estimate loss rates separately for the different 'customer' groups. Groups of debtors for Queensland Government agencies would typically be based on geographic regions (illustrated below), different 'products' or differing customer types (e.g. different revenue streams for fines, goods or services with different characteristics and demonstrated loss patterns different from other revenue streams).

When determining historical credit loss rates, agencies should endeavour to use as much historical data as is available. Ideally, the period of historical data should cover a full economic cycle (e.g. at least 10 years). At a minimum, agencies would be expected to use at least five years of historical data (and longer periods if information is reasonably available in a cost-effective manner.)

Example 2 – Identifying debtor groups with similar loss patterns

The agency expects that debtors within certain geographic regions may have different defaults rates compared to average, in particular:

- A major mining operating in Region A had shut down earlier this year, resulting in uncertainty and high unemployment in the region.
- Region B relies heavily on its tourism industry. In the past number of years, due to environmental damage caused by a multiple weather events and the strong Australian dollar, tourism has fallen significantly in the region.

Based on this assessment, the agency decides it should calculate expected credit losses separately for Region A and Region B. In determining the expected loss rates (see Example 3 below), the agency noted that:

- Region A's historical loss rates are not significantly different from that of other regions. However, the rates are increased to reflect current and expected future conditions for the region.
- Region B's historical loss rates have been higher than that of other regions and the outlook for the region remains the same, no significant recovery is expected in the short term.

The example percentages are for illustrative purposes only.

	Current	1-30 days	31-60 days	60-90 days	>90 days
Region A debtors (higher losses)	0.6%	4.2%	11.8%	19.6%	39.0%
Region B debtors (higher losses)	0.5%	3.6%	9.6%	14.7%	33.9%
All other regions	0.3%	2.1%	5.9%	9.8%	19.5%

The following hypothetical example illustrates a step-by-step approach to calculating expected credit losses for trade receivables using a provision matrix.

Example 3 – Developing a provision matrix

Step 1 – Identify debtor groups with similar loss patterns (see Example 2 above)

An agency has three different revenue streams (A, B and C). Each stream has a different customer base and is processed using a different revenue system. The agency determines that it is appropriate to separately estimate expected loss rates for each revenue stream, due to different customer characteristics and loss patterns.

Step 2 – Obtain historical data

For revenue stream A, the agency has 10 years of available historical data on all debts issued and the subsequent collection or non-collection of those debts. The agency's policy is to write off debts after they are over 90 days overdue, all reasonable recovery efforts have failed, and proper authorisation is obtained for the write off. Details of the 10 years of available historical data is shown in the following table:

All debts issued in the past 10 years	100,000,000
Debts collected by due date	91,700,000
Debts collected between 1-30 days past due	6,200,000
Debts collected between 31-60 days past due	1,000,000
Debts collected between 61-90 days past due	600,000
Debts collected after 90 days overdue	350,000
Debts that were eventually uncollected	150,000

Step 3 – Calculate historical loss rates

Using this data, the agency calculates the historical loss rates for each aging band by dividing the uncollectable debts by the total of debts that had cumulatively fallen within each aging category.

Current	All debts issued in the past 10 years	100,000,000	0.15%	\$150k / \$100M
1-30 days	Debts that had become overdue	8,300,000	1.81%	\$150k / \$8.3M
31-60 days	Debts that had become >30 days overdue	2,100,000	7.14%	\$150k / \$2.1M
61-90 days	Debts that had become >60 days overdue	1,100,000	13.64%	\$150k / \$1.1M
90+ days	Debts that had become >90 days overdue	500,000	30.00%	\$150k / \$500k
	Debts that were eventually uncollected	150,000		

Step 4 – Apply forward-looking adjustments

The agency then considers forecasts of macroeconomic conditions such as unemployment rates and interest rates and their expected impacts on the default rates of revenue stream A customers. Using this forward-looking information, it expects slightly higher loss rates on its current debtor portfolio than the average for the past 10 years. The agency adjusts its historical loss rates upwards by 5% to take this into account.

	Historical loss rate	Forward-looking adjustment (5% increase)	Loss %
Current	0.15%	0.01%	0.16%
1-30 days	1.81%	0.09%	1.90%
31-60 days	7.14%	0.36%	7.50%
61-90 days	13.64%	0.68%	14.32%
90+ days	30.00%	1.50%	31.50%

Step 5 – Calculate the loss allowance

Finally, the agency applies the adjusted loss percentages to the gross carrying amount of its debtors within each aging band to calculate the total lifetime expected credit losses for its revenue stream A debtors.

	Debtor gross carrying amount	Loss %	Lifetime expected credit losses
Current	1,234,000	0.16%	1,944
1-30 days	97,000	1.90%	1,841
31-60 days	31,000	7.50%	2,325
61-90 days	120,000	14.32%	17,182
90+ days	8,000	31.50%	2,520
Loss allowance:			25,811

The agency can use a similar method for its revenue streams B and C debtors. Also, in the following year, the agency will have 11 years of historical data for revenue stream A and accordingly will use 11 years of data to calculate new historical loss rates.

Notes:

If an agency does not have the type of data described in Step 2 above, it can instead use historical monthly debtor aging tables to calculate average roll over rates. For example, the agency can calculate the average percentage of current debts that become 1-30 days overdue in the next month, the average percentage of 1-30 days overdue debts that become 31-60 days overdue in the next month, and so on, and multiply the percentages to arrive at loss rates for each aging band.

The forward-looking adjustment applied in Step 4 above, can be an increase, nil, or a decrease. It can be a decrease if the agency expects better future economic conditions than the period represented by the agency's historical data. This may be the case if the agency's historical data covers a period of economic downturn, and the economy has since recovered.

It is also important to distinguish disputed invoices from impaired debts. If a customer is disputing the validity of an invoice, the agency should assess whether the invoice was correctly raised in the first place. If not, then the receivable may need to be reversed against the original revenue account, rather than through impairment. If the agency believes the invoice is correct, the receivable is included in the impairment calculations.