Guidance document: AASB 9 Financial Instruments

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| AbbreviationsThe following abbreviations are used in this document |
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| Abbreviations | Full form |
| AASB 139 | AASB 139 Financial Instruments: Recognition and Measurement |
| AASB 7 | AASB 7 Financial Instruments: Disclosures |
| AASB 9 | AASB 9 Financial Instruments |
| DTF | Department of Treasury and Finance |
| ECL | Expected credit losses |
| EIR | Effective interest rate |
| FVOCI | Fair value through other comprehensive income |
| FVTPL | Fair value through profit or loss |
| NTPS | Northern Territory public sector |
| SPPI | Solely payments of principal and interest |

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# Introduction

## Purpose

To provide best practice guidance to assist Northern Territory public sector (NTPS) accountable officers and agencies comply with Australian accounting standard AASB 9 Financial Instruments (AASB 9).

Guidance material in this document is not mandatory. If a conflict arises between this document and the Treasurer’s Directions or other legislative requirements, the legislation takes precedence, followed by the Treasurer’s Directions.

## Statement

This guide aims to provide useful information on the classification, measurement, impairment and disclosure of financial instruments under AASB 9. Given the limited use of hedging within the NTPS, this guide does not cover in detail the hedging requirements of financial instruments under AASB 9.

As this document is not a comprehensive guide on AASB 9, agencies are also encouraged to undertake their own reviews of AASB 9.

## Legislative basis and related documents

* *Financial Management Act 1995*
* *Fiscal Integrity and Transparency Act 2001*
* AASB 7 Financial Instruments: Disclosures
* AASB 9 Financial Instruments
* AASB 132 Financial Instruments: Presentation
* AAASB 139 Financial Instruments: Recognition and Measurement

## Background

The *Financial Management Act 1995* and *Fiscal Integrity and Transparency Act 2001* require the Territory’s whole of government consolidated financial statements and agency financial statements to be prepared in accordance with Australian accounting standards.

AASB 9 is effective from 1 July 2018 and applicable to NTPS agency annual financial reports and the Treasurer’s Annual Financial Report from 2018‑19. AASB 9 largely supersedes AASB 139 Financial Instruments: Recognition and Measurement (hedging accounting requirements remain in force) and is in effect with AASB 7 Financial Instruments: Disclosures (AASB 7) and AASB 132 Financial Instruments: Presentation.

# Classification

## Financial assets

A financial asset must be classified as either:

* amortised cost
* fair value through other comprehensive income (FVOCI)
* or fair value through profit or loss (FVTPL).

The classification of a financial asset is determined by the contractual cash flows characteristics test and the business model test (discussed further in section 2.1.1.1 and 2.1.1.2). These two tests should be applied to all financial assets that are debt instruments but is not necessary for financial assets that are equity instruments or derivatives. Due to the nature of equity instruments and derivatives, these assets should always fail the contractual cash flows characteristics test and be classified at fair value through profit or loss or other comprehensive income.

Figure 1 provides an overview of the classification process for financial assets based on whether the financial asset is a debt instrument, equity instrument or derivative. Each step of the classification process is discussed in further detail under its relevant section of the guide.

Figure 1: Classification process for financial assets

|  |
| --- |
| Debt instrumentsEquityinstrumentsContractual cash flows are solely payments of principal and interest (determined at instrument level)Business model(determined at aggregate level)FVTPL option electedAmortised costFVOCI (recycling)Held for tradingFVOCI (no recycling)FVTPLFVOCI option electedNoNoNoNoNoYesYesCollect contractual cash flows OtherCollect contractual cash flows and sellYesYesDerivatives |

Note: The majority of financial instruments held by agencies are expected to be debt instruments that meet the criteria of amortised cost.

### Debt instruments

The classification of financial assets that are debt instruments (for example, trade receivables, loans and advances) is determined by the contractual cash flow characteristics of the financial assets and the business model under which the financial assets are managed.

#### Contractual cash flow characteristics

To classify financial assets that are debt instruments, agencies should determine if the contractual cash flows of a financial asset are solely payments of principal and interest (SPPI), where:

* principal is the fair value of a financial asset at initial recognition
* interest is largely the consideration for the time value of money and credit risk but may include other basic lending risks and a profit margin.

This assessment is made on an instrument by instrument basis and on the facts and circumstances that existed at initial recognition of the financial asset.

Financial assets that do not meet the SPPI criteria are classified as FVTPL. Financial assets that do meet the SPPI criteria are then subject to the business model test (section 2.1.1.2).

For examples of instruments that would and would not meet the SPPI test, refer to AASB 9 paragraphs B4.1.11, B4.1.13 and B4.1.14.

Note: The SPPI criteria can only be met by debt instruments. Equity instruments fail the SPPI criteria as their contractual terms give rise to equity risk and derivatives fail the SPPI criteria as they are considered held for trading. Therefore, the contractual cash flows test and business model test are not required for equity instruments or derivatives.

#### Business model

A business model refers to how an entity manages its financial assets in order to generate cash flows. The following business model categories are used in the classification of financial assets:

* held financial assets to collect contractual cash flows
* held financial assets to collect contractual cash flows and sell
* or none of the above (other).

Table 1 provides an overview of key features of each business model.

Table 1. Key business model features

|  |  |  |
| --- | --- | --- |
| Business model | Features | Classification1 |
| Held to collect | * Objective is to hold assets to collect contractual cash flows
* Sales of financial assets may occur but are incidental to objective
* Sales that do occur are generally:
	+ to manage credit risk
	+ infrequent or insignificant in value
 | Amortised cost |
| Held to collect and sell | * Objective is achieved by collecting contractual cash flows and selling financial assets
* Frequency and value of sales typically greater than held to collect objective
* Examples of objectives may include:
	+ managing everyday liquidity needs
	+ maintaining particular investment returns
 | FVOCI |
| Other | * Business models that are not held to collect or held to collect and sell.
* Example held for trading
 | FVTPL |

1. Subject to meeting SPPI criteria

Business models:

* are determined by an entity’s key management personnel and through actions rather than assertions
* are typically observable through the activities the entity undertakes to achieve the objective of the business model
* should reflect how a group of financial assets are managed together to achieve a specific business objective (it is not an instrument‑by‑instrument determination)
* are determined on the basis of the facts and circumstances that exist at date of initial application of AASB 9.

For examples of business models, refer to AASB 9 paragraphs B4.1.4 and B4.1.4C.

Note: The majority of financial instruments held by agencies are expected to be under the business model “held to collect” (measured at amortised cost, subject to SPPI criteria).

#### Irrevocable designations for debt instruments

Regardless of the outcomes of the cash flow characteristics test and business model test, financial assets that are debt instruments may, at initial recognition, be irrevocably classified as FVTPL if doing so eliminates or significantly reduces an accounting mismatch.

Note: Irrevocable designation for debt instruments should not be common for most agencies. Please contact your Department of Treasury and Finance (DTF) financial analyst prior to applying this designation.

### Derivatives

Derivative financial assets (for example, options, swaps and forward contracts) are classified as FVTPL.

Derivatives do not meet the SPPI criteria as they are considered held for trading.

### Equity instruments

Financial assets that are equity instruments (contracts that evidence a residual interest in the assets of an entity after deducting all of its liabilities) are classified as FVTPL.

Equity instruments do not meet the SPPI criteria as their contractual terms give rise to equity risk.

#### Irrevocable designations for equity instruments

Financial assets that are equity instruments and are not considered to be held for trading may, at initial recognition, be irrevocably classified as FVOCI.

A financial asset is considered to be held for trading if:

* it is acquired or incurred principally for the purpose of selling or repurchasing in the near term
* on initial recognition, it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking
* or it is a derivative.

Where this irrevocable designation is applied, amounts presented in other comprehensive income cannot be reclassified to profit or loss on de-recognition of the financial asset. Dividends on these financial assets are still recognised in profit or loss.

## Financial liabilities

Financial liabilities are classified as amortised cost except for financial liabilities measured at FVTPL. The classification and measurement of financial liabilities remains largely unchanged under AASB 9 compared to AASB 139 Financial Instruments: Recognition and Measurement (AASB 139).

### Irrevocable designations for financial liabilities

An entity may, at initial recognition, irrevocably designate a financial liability at FVTPL if doing so provides more relevant information, because either:

* it eliminates or significantly reduces an accounting mismatch
* or a group of financial liabilities are managed and their performance are evaluated on a fair value basis in accordance with documented risk management or investment strategies, and this information is provided internally to the entity’s key management personnel.

For financial liabilities irrevocably designated at FVTPL, fair value changes due to changes in the liability’s credit risk are recognised in other comprehensive income unless:

* it would create or enlarge an accounting mismatch
* or the financial liability is a financial guarantee contract or loan commitment.

Other changes in fair value of the liability should be presented in profit or loss.

Note: Irrevocable designations for financial liabilities should not be common for most agencies. Please contact your DTF financial analyst prior to applying this designation.

# Measurement

## Initial measurement

Financial instruments should be initially measured at fair value plus or minus, in the case of a financial instrument not at fair value through profit or loss, transaction costs.

## Subsequent measurement

Financial instruments are subsequently measured in line with their classification categories, that is, amortised cost, FVOCI or FVTPL. These measurement methods are largely unchanged under AASB 9 compared to AASB 139, except for the financial assets measured at amortised cost and financial liabilities irrevocably designated at FVTPL.

### Amortised cost

Financial assets classified as amortised cost are subsequently measured at amortised cost using the effective interest method. This method remains largely unchanged under AASB 9 compared to AASB 139 except for the calculation of interest income that is now dependent on the impairment status of the financial asset. For financial assets that:

* are not credit-impaired, interest income is calculated by applying the effective interest rate (EIR) to the gross carrying amount of the financial asset
* are credit-impaired, interest income is calculated by applying the EIR to the amortised cost of the financial asset, that is, the carrying amount less credit losses
* previously credit-impaired but are no longer considered to be credit‑impaired, interest income can be calculated, in subsequent periods, on the gross carrying amount.

### Financial liabilities

Financial liabilities are subsequently measured at amortised cost or FVTPL. The subsequent measurement of financial liabilities remains largely unchanged under AASB 9 compared to AASB 139, except for financial liabilities irrevocably designated at FVTPL.

For financial liabilities irrevocably designated at FVTPL, fair value changes due to changes in the liability’s credit risk are recognised in other comprehensive income unless:

* it would create or enlarge an accounting mismatch
* or the financial liability is a financial guarantee contract or loan commitment.

## Reclassification of financial instruments

When, and only when, an entity changes its business model for managing financial assets, all affected financial assets should be reclassified in accordance with the business model and cash flow characteristics test. Financial liabilities cannot be reclassified.

For examples of what are and are not changes in business models, refer to AASB 9 paragraphs B4.4.1 and B4.4.3.

Note: Business model changes should be infrequent for agencies.

If the reclassification of a financial asset is required, the reclassification should be from the reclassification date, which is the first day of the next reporting period following the change in business model. Prior periods are not restated.

The reclassification of a financial asset may require the remeasurement of its carrying amount or fair value. An overview of potential remeasurements due to the reclassification of a financial asset is provided in Table 2.

**Table 2: Accounting impact of reclassification**

|  |  |  |
| --- | --- | --- |
| Original category | New category | Accounting impact |
| Amortised cost | FVTPL | * Fair value is measured at reclassification date
* Difference between the amortised cost and fair value is recognised in profit or loss
 |
| Amortised cost | FVOCI | * Fair value is measured at reclassification date
* Difference between the amortised cost and fair value is recognised in other comprehensive income
 |
| FVTPL | Amortised cost | * Fair value at reclassification date becomes the asset’s new gross carrying amount
* Effective interest rate is determined on the basis of the fair value at reclassification
 |
| FVTPL | FVOCI | * Asset continues to be measured at fair value
* Effective interest rate is determined on the basis of the fair value at reclassification
 |
| FVOCI | Amortised cost | * Reclassified at fair value at reclassification date
* Cumulative gain or loss in other comprehensive income is adjusted against the fair value of the financial asset at reclassification date
 |
| FVOCI | FVTPL | * Asset continues to be measured at fair value
* Cumulative gain or loss in other comprehensive income is reclassified to profit or loss at reclassification date
 |

For further information on remeasurement requirements due to reclassifications, refer to AASB 9 paragraphs 5.6.2 to 5.6.6.

# Impairment

Impairment recognition under AASB 9 is based on an expected credit loss model which requires impairment losses to reflect the following principles:

* a probability-weighted outcome
* the time value of money
* any reasonable and supportable information, including that which is forward-looking.

The principles above, together with other key impairment concepts are discussed further in section 4.3.

The requirement for “any reasonable and supportable information” broadens the scope of information agencies should consider when recognising impairments, including past events, current conditions and forecasts of future economic conditions. This differs from AASB 139, which recognises impairments only when there is objective evidence of impairment and losses expected as a result of future events, no matter how likely.

Impairments are recognised on a 12-month expected credit loss (ECL) basis if there has been no significant increase in credit risk since initial recognition of the financial instrument, and lifetime ECL if there has been a significant increase in credit risk.

There are two approaches to impairment recognition:

* simplified approach
* general approach.

## Simplified approach

The simplified approach to impairment recognition requires agencies to measure financial instruments on a lifetime ECL basis, regardless of an instrument’s credit risk.

Agencies must apply the simplified approach to trade receivables and contract assets without significant financing components (as defined under AASB 15: Revenue from Contracts with Customers). Agencies may elect to apply this approach to all other trade receivables and contract assets, as well as lease receivables.

Note: Agencies should apply the simplified approach to all trade receivables, contract assets and lease receivables.

AASB 9 does not specify a method for impairment recognition and only requires methods used to be consistent with the principles of impairment. Agencies with a small quantity of financial instruments may find it simpler to assess impairments on an individual instrument basis, while entities with a large number of financial instruments may use a provision matrix. Examples of each method is illustrated in sections 4.1.1 and 4.1.2.

### Example – Individual assessment

Entity A has six trade receivables at 30 June 2019 that it assesses for impairment on an individual basis. In undertaking it assessment, Entity A:

* determines probability of defaults using historical default rates as a base, adjusted for any reasonable and supportable information for each individual debtor
* determines its loss given default (the amount Entity A expects to lose should the debtor default) as the amount outstanding for each debt less any expected recoveries.

An illustrative example of its assessment is provided in Table 3.

Table 3: Example of individual assessment

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Trade receivable | Amount | Probability of default(A) | Loss given default(B) | ECL(A x B) | Days overdue | Assessment notes |
| A | $1 000 |  1% |  $1 000 |  $10 | Not overdue | Probability of default based on historical rates of debtor defaults. |
| B | $4 000 |  1% |  $4 000 |  $40 | Not overdue | Probability of default based on historical rates of debtor defaults. |
| C | $15 000 |  2% |  $15 000 |  $300 | Not overdue | Probability of default based on historical rates of debtor defaults and debtor’s request for repayment extension.  |
| D | $1 500 |  20% |  $1 500 |  $300 | Over 30 days | Probability of default based on historical rates of debtor defaults that were more than 30 days overdue.  |
| E | $5 000 |  90% |  $5 000 |  $4 500  | Over30 days | Probability of default based on historical rates of debtor defaults that were more than 30 days overdue and fact that debtor is ceasing trading. |
| F | $10 000 |  100% |  $9 000 |  $9 000 | Over60 days | Probability of default based on historical rates of debtor defaults that were more than 60 days overdue. Based on correspondence with debtor, Entity A expects to only recover $1 000.  |
| **Total** | **$36 500** |  |  | **$14 150** |  |  |

As a result of Entity A’s assessment, it recognises an impairment loss allowance of $14 150 (assuming no existing impairment allowance exists).

Journal to recognise the impairment loss allowance adjustment as at 30 June 2019:

|  |  |  |  |
| --- | --- | --- | --- |
| DR | Doubtful debts expense | $14 150 |  |
| CR | Allowance for doubtful debts |  | $14 150 |

### Example – Provision matrix

Entity A has a significant number of trade receivables and elects to use a provision matrix as a practical expedient to calculate its ECL at 30 June 2019. The provision matrix assigns expected credit loss percentages to different ageing bands of trade receivables to estimate ECL for the whole portfolio.

Entity A determines that all of its trade receivables share similar risk characteristics and therefore do not need to be segmented with different loss rates.

Note: Agencies should group trade receivables with similar risk characteristics within the same provision matrix. Agencies with multiple groupings of trade receivables should have multiple provision matrices, for example, an agency’s domestic trade receivables and international trade receivables may have materially different risk characteristics and therefore require separate provision matrices.

At 30 June 2019, Entity A reviews its historical rates of default on its trade receivables and determines its historical credit loss rates as below:

|  |  |
| --- | --- |
| Days past due | Historical credit loss rate |
|  | % |
| Not past due | 2.5 |
| Less than 30 days  | 3.0 |
| 30 to 59 days | 4.0 |
| 60 to 89 days | 5.0 |
| 90 days and over | 15.0 |

Entity A considers current conditions and forward-looking information relevant to its portfolio of trade receivables and assesses for their impact on trade receivables. Entity A determines that changes in the unemployment rate is correlated to the credit risk of its trade receivables and from past experience, a one per cent change in the unemployment rate approximates a five per cent change in its default rates.

As such, Entity A increases its historical credit loss rates by five per cent to account for a forecasted one per cent increase in the unemployment rate. This gives Entity A’s expected credit loss rates of:

|  |  |  |  |
| --- | --- | --- | --- |
| Days past due | Historical credit loss rate | Adjustment (5% increase) | ECL rate |
|  | % | % | % |
| Not past due | 2.5 | 0.13 | 2.63 |
| Less than 30 days | 3.0 | 0.15 | 3.15 |
| 30 to 59 days | 4.0 | 0.20 | 4.20 |
| 60 to 89 days | 5.0 | 0.25 | 5.25 |
| 90 days and over | 15.0 | 0.75 | 15.75 |

Entity A applies the ECL rate to the gross carrying amount of its trade receivables in each aging band to determine its impairment allowance.

|  |  |  |  |
| --- | --- | --- | --- |
| **Days past due** | **Carrying** **amount** **(A)** | **ECL rate****(B)** | **ECL****(A x B)** |
|  | $ | % | $ |
| Not past due | 15 000 | 2.63 | 395 |
| Less than 30 days | 8 000 | 3.15 | 252 |
| 30 to 59 days | 5 000 | 4.20 | 210 |
| 60 to 89 days | 3 000 | 5.25 | 158 |
| 90 days and over | 1 000 | 15.75 | 158 |
| **Total** | **32 000** |  | **1 173** |

As a result of Entity A’s assessment, it recognises an impairment loss allowance of $1 173 (assuming no existing impairment allowance exists).

Journal to recognise the impairment loss allowance adjustment as at 30 June 2019:

|  |  |  |  |
| --- | --- | --- | --- |
| DR | Doubtful debts expense | $1 173 |  |
| CR | Allowance for doubtful debts |  | $1 173 |

## General approach

The general approach to impairment recognition requires agencies to recognise impairments on either a 12-month basis or lifetime basis depending on the credit risk of a financial asset.

If the credit risk of a financial asset (or group of financial assets) has not significantly increased since initial recognition, expected credit losses are recognised on a 12-month basis. If the credit risk has significantly increased since initial recognition or the financial asset is considered to be credit‑impaired, expected credit losses are recognised on a lifetime basis.

The general approach is commonly summarised in three stages as shown in Table 4.

**Table 4: Three stages of the general approach**

|  |  |  |  |
| --- | --- | --- | --- |
|  | Stage 1 (performing) | Stage 2 (underperforming) | Stage 3 (non-performing) |
| **Risk** | Credit risk of financial instrument has not significantly increased since initial recognition | Credit risk of financial instrument has significantly increased since initial recognition | Financial instruments are credit‑impaired |
| **Method** | Recognise 12-month ECL | Recognise lifetime ECL |
| **Interest** | Interest income calculated by applying effective interest rate (EIR) on gross carrying amount of financial asset | Interest income calculated by applying EIR on amortised amount of financial asset |

Financial instruments with impairments recognised at lifetime ECL can, in subsequent periods, recognise impairments at 12-month ECL if:

* credit risk of the financial instrument is no longer considered to have significantly increased
* or the financial instrument is no longer considered credit-impaired.

Purchased or originated credit-impaired financial assets can only recognise lifetime ECL.

### Example – General approach

Entity A provides a five-year loan of $500 000 to Entity B on 1 July 2018. Contractual repayments of $100 000 are required at 30 June each year over the next five years. Entity A estimates the following impairments at each period:

**1 July 2018**

Entity A determines the 12 month and lifetime probabilities of the loan defaulting (2 per cent and 7 per cent respectively) using historical rates of default and any reasonable and supportable information. Entity A does not collect any collateral on the loan and expects its loss given a default event occurring to be the full value of the outstanding loan ($500 000).

|  |  |  |  |
| --- | --- | --- | --- |
|  | Probability of default |  | ECL |
|  | **within 12 months****(A)** | **remaining term****(B)** | **lifetime****(C) = A + B** | **loss given default****(D)** | **12-month****A x D** | **lifetime** **C x D** |
|  | % | % | % | $ | $ | $ |
| 1 July 2018 | 2 | 5 | 7 | 500 000 | 10 000 | 35 000 |

As this is the initial recognition of the loan and the loan is not considered purchased or originated credit-impaired, an impairment loss allowance equal to 12-month ECL is recognised ($10 000).

Journal to recognise the impairment loss allowance adjustment as at 1 July 2018:

|  |  |  |  |
| --- | --- | --- | --- |
| DR | Doubtful debts expense | $10 000 |  |
| CR | Allowance for doubtful loans |  | $10 000 |

 **30 June 2019**

Entity A updates the probabilities of the loan defaulting with any reasonable and supportable information, as well as its expected loss given default.

Entity A notes that, since issuing the loan, there have been ongoing economic downturns in the market in which Entity B primarily operates and adjusts its default probabilities accordingly. Entity A also updates its loss given default to account for the first $100 000 repayment.

|  |  |  |  |
| --- | --- | --- | --- |
|  | Probability of default |  | ECL |
|  | **within 12 months****(A)** | **remaining term****(B)** | **lifetime****(C) = A + B** | **loss given default****(D)** | **12-month****A x D** | **lifetime** **C x D** |
|  | % | % | % | $ | $ | $ |
| At 1 July 2018 | 2 | 5 | 7 | 500 000 | 10 000 | 35 000 |
| At 30 June 2019 | 8 | 7 | 15 | 400 000 | 32 000 | 60 000 |

Entity A notes there has been an eight per cent (15 per cent less seven per cent) increase in credit risk since initial recognition (seven per cent) which it considers to be significant. As a result, Entity A recognises an impairment loss allowance equal to lifetime ECL ($60 000).

As Entity A has already recognised an impairment loss allowance of $10 000 at 1 July 2018, it must increase the impairment loss allowance by a further $50 000 at 30 June 2019
($60 000 - $10 000).

Journal to recognise the impairment loss allowance adjustment as at 30 June 2019:

|  |  |  |  |
| --- | --- | --- | --- |
| DR | Doubtful debts expense | $50 000 |  |
| CR | Allowance for doubtful loans |  | $50 000 |

 **30 June 2020**

Entity A updates the probabilities of the loan defaulting with any reasonable and supportable information, as well as its expected loss given default.

Entity A notes the market in which Entity B primarily operates has been experiencing a recovery and adjusts its default probabilities accordingly. Entity A also updates it loss given default to account for the second $100 000 repayment.

|  |  |  |  |
| --- | --- | --- | --- |
|  | Probability of default |  | ECL |
|  | **within 12 months****(A)** | **remaining term****(B)** | **lifetime****(C) = A + B** | **loss given default****(D)** | **12-month****A x D** | **lifetime** **C x D** |
|  | % | % | % | $ | $ | $ |
| At 1 July 2018 | 2 | 5 | 7 | 500 000 | 10 000 | 35 000 |
| At 30 June 2019 | 8 | 7 | 15 | 400 000 | 32 000 | 60 000 |
| At 30 June 2020 | 3 | 6 | 9 | 300 000 |  9 000 | 27 000 |

Entity A notes there has been a 2 per cent (nine per cent less seven per cent) increase in credit risk since initial recognition (seven per cent) which it considers to be insignificant. As a result, Entity A recognises an impairment loss allowance equal to 12‑month ECL ($9 000).

As Entity A has already recognised an impairment loss allowance of $60 000 at 30 June 2019, it must decrease the impairment loss allowance by $51 000 at 30 June 2020 ($9 000 - $60 000).

Journal to recognise the impairment loss allowance adjustment as at 30 June 2020:

|  |  |  |  |
| --- | --- | --- | --- |
| DR | Allowance for doubtful loans | $51 000 |  |
| CR | Doubtful debts expense |  | $51 000 |

## Exemptions to impairment testing

Financial instruments measured at FVTPL and equity instruments are exempt from impairment testing.

Note: Agencies must exclude impairment testing on financial instruments transacted with other NTPS agencies. No impairment allowances should be recognised for inter‑agency transactions.

## Key concepts of impairment

### Credit losses

Credit losses are the difference between all contractual cash flows due and all the cash flows that an entity expects to receive, discounted at the original or credit-adjusted effective interest rate, that is, the present value of the expected cash shortfalls.

### Expected credit losses

ECL are the weighted average of credit losses with the respective risks of default occurring as the weights, that is, the probability-weighted estimate of the present value of the expected cash shortfalls.

Practical expedients may be used to determine ECL provided impairment recognition reflects a probability-weighted outcome, the time value of money and reasonable and supportable information.

#### Lifetime ECL

Lifetime ECL are ECL that result from all possible default events over the expected life of a financial instrument. Impairments will be recognised at lifetime ECL where the credit risk of a financial instrument has significantly increased since initial recognition.

#### 12-month ECL

12-month ECL represent the lifetime cash shortfalls that will result if a default occurs in the 12 months after the reporting date, weighted by the probability of that default occurring.

12-month ECL are not simply the cash shortfalls that are predicted over the next 12 months.

### Probability-weighted outcome

ECL are required to reflect an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes. This does not need to be a complex analysis. For example, for a large group of financial instruments with shared risk characteristics, the average credit losses may be a reasonable estimate of the probability-weighted outcome.

Entities are not required to identify every possible scenario but should reflect, at a minimum:

* the probability that no credit loss occurs
* the probability that a credit loss occurs, even if this probability is low.

### Time value of money

ECL should be discounted to the reporting date using the effective interest rate determined at initial recognition or an approximation thereof.

Lease receivables will apply the same rate used in measuring the lease receivables.

### Reasonable and supportable information

Reasonable and supportable information is that which is reasonably available at the reporting date without undue cost or effort including information about past events, current conditions and forecasts of future economic conditions.

Reasonable and supportable information should include:

* factors that are specific to the borrower
* general economic conditions
* an assessment of both the current and forecast directions of conditions.

An entity is not required to undertake an exhaustive search for information or forecast future conditions over the entire expected life of a financial instrument. For periods that are far in the future, an entity may extrapolate projections from available detailed information.

Historical information is a useful base for measuring ECL but should be adjusted to reflect current observable data on current conditions and forecasts of future conditions. Examples of current observable data include consumer price index, unemployment rate and wage price index.

The DTF’s published economic briefs may provide a useful basis for assessing current and future economic conditions. These briefs are available from the DTF economic briefs [website](https://treasury.nt.gov.au/dtf/economic-group/economic-briefs).

### Significant increase in credit risk

Impairments are recognised at lifetime ECL if credit risk of a financial instrument has significantly increased since initial recognition. This assessment is based on the change in the risk of default occurring over the expected life of the financial instrument, not the change in the amount of expected credit losses.

To assist in this assessment, AASB 9 allows the following practical expedients:

* if a financial instrument is determined to have low credit risk at the reporting date, an entity may assume that the credit risk has not significantly increased
* if contractual payments of a financial instrument are more than 30 days past due, a rebuttable presumption exists that credit risk has significantly increased.

For examples of information that can be used in assessing changes in credit risk, refer to AASB 9 paragraph B5.5.17.

### Credit-impaired financial asset

A financial asset is considered credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred. Examples of such events include:

* significant financial difficulty of the issuer or borrower
* a breach of contract, such as a default or past due event
* probable bankruptcy of the borrower.

# Hedging

The objective of hedge accounting under AASB 9 is to represent in the financial statements, the effect of an entity’s risk management activities that use financial instruments to manage exposures arising from particular risks that could affect the operating result.

Among other changes, AASB 9 has broadened the exposures that can be subject to hedge accounting, increased the scope of items that can be classified as a hedged item and removed the “80‑125 per cent” hedge effectiveness test. The use of hedge accounting remains optional under AASB 9.

Agencies with hedging transactions are encouraged to undertake their own reviews of AASB 9 and contact their DTF analyst if further assistance is required.

Note: Agencies with hedge accounting should transition from the requirements of AASB 139 to AASB 9.

# Disclosures

The introduction of AASB 9 includes various amendments and additions to the disclosure requirements under AASB 7. While example disclosures on financial instruments are provided in the DTF’s agency financial statements proforma, agencies should also undertake their own reviews of AASB 7 for any additional disclosures specific to them.

Significant disclosure changes following the introduction of AASB 9 include, but are not limited to, disclosures on:

* investments in equity instruments designated at FVOCI (AASB 7 paragraphs 11A and 11B)
* the reclassification of financial assets (AASB 7 paragraphs 12B to 12D)
* credit risk, in particular credit risk management practices, quantitative and qualitative information on amounts arising from expected credit losses and exposure (AASB 7 paragraphs 35A to 35N)
* the initial application of AASB 9 (AASB 7 paragraphs 42I to 42S).