9 Financial Instruments

Chapter 9 Contents

9.1 Introduction

9.1.1 This chapter deals with accounting for financial instruments.

9.2 Accounting standards

9.2.1 The following accounting standards and Interpretations deal with accounting for financial instruments:

IAS 32 *Financial Instruments: Presentation*

IAS 39 *Financial Instruments: Recognition and Measurement*

IFRS 7 *Financial Instruments: Disclosures*

IFRIC 2 *Members' Shares in Co-operative Entities and Similar Instruments*

IFRIC 9 *Reassessment of Embedded Derivatives*

IFRS 4 *Insurance contracts*

IAS 33 *Earnings per Share*, IFRS 2 *Share-based payment* and IFRIC 8 *Scope of IFRS 2* are unlikely to apply, but if they do apply, they apply in full.

IAS 32 Financial Instruments: Presentation

Applicability

9.2.2 IAS 32 applies, as interpreted, to all reporting entities and reportable activities covered by the Manual.

Objective of IAS 32

9.2.3 The objective of IAS 32 is to establish principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities.

Interpretation of IAS 32 for the public sector context

9.2.4 Public Dividend Capital is not an equity instrument as defined in the IAS. It should be presented as a form of financing in the statement of financial position of the relevant entity. Dividends on PDC should be presented in the income and expenditure account and accounted for where appropriate in the statement of financial position.

IAS 39 Financial Instruments: Recognition and Measurement

Applicability

9.2.5 IAS 39 applies, as interpreted, to all reporting entities and reportable activities covered by the Manual.

Objective of IAS 39

9.2.6 The objective of IAS 39 is to establish principles for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items.

Interpretations of IAS 39 for the public sector context

9.2.7 The following interpretations of IAS 39 for the public sector context apply.

Recognition

a) Any financial instrument that is not held in furtherance of the entity's objectives but is held on behalf of government more generally should be accounted for in a separate Trust Statement. Entities should discuss such cases with the relevant authorities.

b) Special or 'golden' shares, being those shares retained in businesses that have been privatised but in which the department wishes to retain a regulatory interest or reserve power, should not be recognised in the statement of financial position.

Measurement

c) Loans, Public Dividend Capital and other interests in public bodies outside the departmental boundary (see paragraph 4.2.12) should be reported at historical cost, less any impairment.

d) Where future cash flows are discounted to measure fair value, entities should use the higher of the rate intrinsic to the financial instrument and the real discount rate set by HM Treasury as applied to the flows expressed in current prices.

e) Liabilities under financial guarantee contracts that are not accounted for as insurance contracts should be measured initially at their fair value and, as appropriate, amortised subsequently to the Statement of Comprehensive Net Expenditure or its equivalent. Subsequent changes in probabilities should not be reflected in the carrying value except where the result is that IAS 37 would require recognition of a liability because it is more probable than not that a transfer of resources will occur.

Other requirements

9.2.8 The following requirement should be observed by entities covered by this Manual. IAS 39 includes a number of alternative accounting treatments. Entities should discuss any significant choices to be made with the relevant authorities (through sponsoring bodies where appropriate) to ensure that the budgeting implications have been properly considered. Examples are:

a) the designation of financial assets and liabilities as at fair value through profit and loss, and of non-derivative financial assets as available for sale;

b) the reclassification of financial assets and liabilities;

c) the election to apply IAS 39 or continue to use accounting applicable to insurance contracts to financial guarantee contracts; and

d) the use of hedge accounting.

IFRS 7: Financial Instruments: Disclosures

Applicability

9.2.9 IFRS 7 applies in full to all reporting entities and reportable activities covered by the Manual.

Objective of IFRS 7

9.2.10 The objective of IFRS 7 is to require entities to provide disclosures in their financial statements that enable users to evaluate:

(a) The significance of financial instruments for the entity's financial position and performance; and

(b) The nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the reporting date, and how the entities manage those risks.

IFRIC 2: Members' Shares in Co-operative Entities and Similar Instruments

Applicability

9.2.11 IFRIC 2 applies in full to all reporting entities covered by the Manual.

Consensus

9.2.12 The consensus in the Interpretation is that, for the purposes of classifying as debt or equity, financial instruments that have characteristics of equity, including voting rights and rights to participate in dividend distributions, but also give the holder limited rights to request redemption for cash or another financial asset, the entity must consider all of the terms and conditions of the financial instrument. These include relevant local laws, regulations and the entity's governing charter in effect at the date of classification, but not expected future amendments to those laws, regulations or charter.

IFRIC 9: Re-assessment of Embedded Derivatives

Applicability

9.2.13 IFRIC 9 applies in full to all reporting entities and reportable activities covered by the Manual.

Consensus

9.2.14 The consensus in the Interpretation is that an entity shall assess whether an embedded derivative is required under IAS 39 to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required.

IFRS 4: Insurance Contracts

Applicability

9.2.15 IFRS 4 applies in full to all reporting entities covered by the Manual.

Objectives of IFRS 4

9.2.16 The objective of IFRS 4 is to specify the financial reporting for insurance contracts by any entity that issues such contracts until the Board completes the second phase of its project on insurance contracts. In particular, IFRS 4 requires:

a) limited improvements to accounting by insurers for insurance contracts; and

b) disclosure that identifies and explains the amounts in an insurer's financial statements arising from insurance contracts and helps users of those financial statements understand the amount, timing and uncertainty of future cash flows from insurance contracts.