|  |  |  |  |
| --- | --- | --- | --- |
| FRD 116A |  |  | Financial instruments – public financial corporations (June 2016) |
|  |  |  |  |
| Purpose | 1. 1 |  | To prescribe for public financial corporations (PFCs) the criteria for the designation of financial assets and financial liabilities. |
| Application |  |  | Applies to all entities classified as public financial corporations in the Annual *Financial Report for the State of Victoria*. |
| Operative date |  |  | Annual reporting periods commencing on or after 1 July 2015. |
|  |  | 3.2 | FRD 116 *Financial instruments – public financial corporations* is withdrawn and superseded effective 1 July 2016. |
| Requirements |  |  | Designation of financial assets and financial liabilities:  Entities within the scope of this FRD shall, for their own financial reporting, adopt designation, measurement and presentation policies for financial instruments that comply with accounting standards and that are appropriate for the risk management and performance evaluation policies adopted by the entity. |
|  |  |  | Adjustment of information for consolidation purposes:  Although entities in the scope of this FRD may have adopted designation and measurement policies for their own purposes, they shall comply with the following requirements when submitting their financial information for consolidation in financial reports of the whole of State of Victoria adjust this information to: |
|  |  |  | 1. Unless required to use some other basis by an accounting standard other than AASB 139, loans and receivables or financial liabilities shall be measured at amortised cost if the counter‑party to the transaction is another entity controlled by the State of Victoria. The Consolidated Reporting and Analysis team of the Department of Treasury and Finance (DTF) shall be informed if a basis other than amortised cost is used to measure such financial assets and financial liabilities. 2. Financial assets or financial liabilities classified as ‘held for trading’ shall be measured at fair value through profit and loss. 3. Financial assets that are within the scope of AASB 139 and that support general insurance liabilities shall be reported at fair value through profit and loss. 4. Loans and receivables that are not quoted in an active market shall be measured at amortised cost. 5. In certain cases, there may be a preference for classifying certain financial assets as ‘held‑to‑maturity’. In such cases (because of the risk of tainting the class), entities shall seek prior written approval from DTF for nominated financial assets to be classified as ‘held‑to maturity’. As such they are measured at amortised cost, subject to reassessment at each balance date. Typically these would be term deposits where the intention and practice is to hold to maturity. 6. All derivatives (other than those designated as an accounting hedge) shall be recognised as a financial asset or financial liability at fair value through profit and loss. |
|  |  |  | 1. All other financial assets shall be classified as ‘available for sale’. As such they shall be measured at fair value with movements (other than related to interest on any foreign exchange component of the fair value) reflected in equity until the asset is derecognised. Interest income for financial assets classified as ‘available for sale’ is recognised directly in profit and loss and based on amortised cost. 2. Financial liabilities that are not quoted in an active market shall bemeasured at amortised cost. |
|  |  |  | 1. The following are excluded from the above requirements:    1. interests in subsidiaries, associates and joint ventures; employers’ rights and obligations under employee benefit plans, finance leases and liabilities under insurance contracts or other types of financial instruments excluded from the scope of AASB 132 and AASB 139;    2. financial instruments for which the Consolidated Reporting and Analysis team of DTF has given the entity prior written approval to treat in a particular way. |
|  |  |  | 1. If formal hedge accounting compliant with AASB 132/139 is applied to an anticipated transaction related to non-financial assets and liabilities (such as capital and inventory purchases) and subsequently results in the recognition of a non‑financial asset or a non‑financial liability, then an entity shall remove any associated gains and losses recognised directly in equity (hedging reserve) in accordance with the requirements for accounting for cash flow hedges contained within AASB 139, and include them in the initial cost or other carrying amount of the asset. |
|  |  |  | 1. The matrix set out in Appendix A outlines these requirements. |
| Definitions |  |  | ***Embedded derivatives:*** a component of a hybrid (combined) instrument that also includes a non‑derivative host contract – with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand‑alone derivative.  ***Hedge accounting****:* the practice of identifying certain transactions as establishing a hedge against unwanted variations in other transactions and then accounting for these hedge transactions by valuing them at fair value and either recording movements immediately in profit and loss or where appropriate deferring any gain or loss within equity until the transaction being hedged is complete and it is considered appropriate to transfer the movement to profit and loss (‘on balance sheet’ hedge accounting). AASB 132/139 allows these practices, but with strict rules about designation, measurement and effectiveness. Another former practice was referred to as ‘off balance sheet’ hedge accounting and involved ignoring movements in value until the hedged transaction was complete. This practice is disallowed under AASB 132/139. |
|  |  |  | ***Loans and receivables:*** non‑derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:  those that the entity intends to sell immediately or in the near term, which consequently are classified as ‘held for trading’, and those that the entity upon initial recognition designates as at fair value through profit or loss;  those that the entity upon initial recognition designates as ‘available for sale’; or  those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, and which are classified as ‘available for sale’.  An interest acquired in a pool of assets that are not loans or receivables (e.g. an interest in a mutual fund or a similar fund) is not a loan or receivable. |
| Guidance |  |  | Designation and measurement:  FRD 114B includes guidance extracted from AASB 139 which is intended to assist entities that are less familiar with this standard. |
|  |  |  | FRD 114B Appendix B contains an example of calculating the amortised cost of a financial liability. |
|  |  |  | Request to nominate financial assets as ‘Held to Maturity’:  Requests to nominate financial assets as ‘held to maturity’ shall be addressed to the Consolidated Reporting and Analysis team of DTF’s Budget Finance Division, who will respond after consultation, as required, with Accounting Policy and Balance Sheet Management team. |
|  |  |  | Hedge accounting restrictions:  Due to the complexities and difficulties in complying with AASB 132/139 for hedge accounting, it is strongly recommended that entities do not apply hedge accounting. This recommendation to avoid the use of formal hedge accounting should not discourage an entity from entering into derivative financial instruments to manage financial risks, such as its interest rate or currency risks inherent in its borrowing or asset management activities. There shall be consistency in the way that the derivatives and the underlying instruments concerned are recorded, measured and values adjusted |
| Relevant pronouncements |  |  | AASB 101 *Presentation of Financial Statements* (December 2013);  AASB 132 *Financial Instruments: Disclosure and Presentation* (December 2013);  AASB 139 *Financial Instruments: Recognition and Measurement* (June 2014); and  FRD 114B *Financial instruments – general government entities and public non‑financial corporations* (June 2016). |
| Background |  |  | AASB 139 was amended (by AASB 2005‑4) to impose stringent criteria on the circumstances under which AASB 139 allows any financial asset or financial liability to be designated when initially recognised as a financial asset or financial liability at fair value through profit or loss. With some exceptions, this FRD requires all financial assets (and liabilities) that will be incorporated in the financial results and position of the whole of state to be classified as ‘available for sale’ and so measured at fair value with movements in fair value to be recognised in equity, until the financial instrument is derecognised and the movements shall be recognised in the operating statement.  The ‘held to maturity’ financial asset designation allowed under AASB 139 requires DTF’s written approval before an entity can adopt these designations. Sales or reclassifications of held‑to‑maturity assets, other than the limited exceptions outlined in this FRD and AASB 139, result in any remaining held‑to‑maturity assets being reclassified as ‘available‑for‑sale’ and recorded in the reporting period in which the sale or transfer occurred. Further, if an entity is not permitted to use the ‘held‑to‑maturity’ designation as a result of a sale or reclassification, this designation also cannot be used in the consolidated financial statements of the State of Victoria.  If a hedge of the purchase or sale of a capital item or any other unrecognised firm commitment, or highly probable forecast transaction, results in the recognition of a non‑financial asset or non‑financial liability, then the standard allows an entity to either (a) reclassify hedging gains/losses into profit/loss in the same periods in which the asset or liability affects profit/loss; or (b) transfer the hedging gains/losses into the initial carrying amount of the asset/liability. This FRD limits the choice to option (b) to ensure consistency and that the cost of the asset reflects any hedging performed.  The requirements for valuing general insurance assets and liabilities are specified by AASB 1023 *General Insurance Contracts*. Liabilities arising from such contracts should be valued in accordance with this Standard. Included in the claims measurement (para 5.1) requirements in AASB 1023 5.1, is the requirement for ‘an additional risk margin to allow for the inherent uncertainty in the central estimate’. In October 2005, DTF issued Prudential Guideline No 1 ‘*Valuation of Outstanding Claims Liabilities by Statutory Insurance Agencies’.* Valuation of liabilities shall be in accordance with the Standard and this Prudential Guideline (refer to July 2015 update below).  Financial assets that are within the scope of AASB 139, and that back general insurance liabilities shall be designated ‘at fair value through profit or loss’ by Accounting Standard [AASB 1023 (Para 15.2)]. The basis used to determine which assets back insurance liabilities shall be documented and is a required disclosure item (AASB 1023 Para 17.3). Once an asset has been identified as backing general insurance liabilities, there is no alternative valuation method permissible for that asset if it is a financial asset to which AASB 139 applies. This requirement ensures that valuation of the assets arising from insurance liabilities, for example reinsurance and other recoveries receivable, are valued in a manner that is consistent with the assumptions used in the claims liability valuation. This requirement is consistent with the more restrictive criteria of AASB 2005‑4 which revised AASB 139 to restrict fair‑valuing of financial instruments to certain categories, one of which is where measuring the instrument at fair value through profit and loss eliminates or reduces a measurement inconsistency or is part of a group of financial assets or financial liabilities managed on a fair value basis. |
|  |  |  | Before the introduction of A‑IFRS, the market borrowings held by TCV were revised to amortised cost on consolidation in the *Financial Report for the State of Victoria*. Commencing with 2005‑06, there shall be no adjustment to these liabilities and consequently these borrowings shall be recorded at fair value in the *Financial Report for the State of Victoria*.  In July 2015 DTF issued the *Prudential Insurance Standard for Victorian Government insurance agencies* – 1 July 2015.  This FRD was revised in June 2016 to remove the first‑time adoption requirements, as they are no longer required. References to comparative information were removed as it applies to transitional periods. The ‘Model for Disclosure within Financial Report’ section was also removed as this disclosure has been included in the *Model Report for Victorian Government Departments*. |

# Appendix A

## Financial instruments information for consolidation purposes in whole‑of‑state financial statements

| **Financial instrument** |  | **Measured at** | | |  |
| --- | --- | --- | --- | --- | --- |
| **Designations requiring  DTF prior approval** | **Fair value** | |  | **Subject to impairment** |
| **Thru P&L** | **Thru equity** | **Amortised cost** |
| Asset loans and receivables   * Term deposits not quoted in an active market * Receivables, including trade debtors and loans, that are not quoted in an active market and the entity has no intention to sell the assets |  |  |  | **√**  **√** | **√**  **√** |
| Assets at fair value through profit or loss   * Receivables that are not designated as ‘loans and receivables’ nor ‘available for sale’ nor ‘held‑to‑maturity’ * Shares and other equity investments quoted in an active market or able to be reliably measured (see footnote \*) * Financial assets that back general insurance liabilities |  | **√**  **√**  **√** |  |  |  |
| Assets available for sale   * Receivables that are not designated as ‘loans and receivables’ nor ‘assets at fair value through profit or loss’ nor ‘held‑to‑maturity’ * Term deposits that are not designated as ‘held‑to‑maturity’ nor ‘loans and receivables’ * Debt securities and other placements (assuming the securities may be sold before maturity) * Shares that are not designated as ‘at fair value through profit or loss’ |  |  | **√**  **√**  **√**  **√** |  | **√**  **√**  **√**  **√** |
| Assets (quoted in an active market) held‑to‑maturity   * Receivables that are not designated as ‘assets at fair value through profit or loss’ nor ‘available‑for‑sale’ * Term deposits that are not designated as ‘available for sale’ nor ‘loans and receivables’ and where intention and practice is to hold to maturity * Debt securities and other placements that are not designated as ‘fair value through profit or loss’ nor ‘available‑for‑sale’ | √   √  √ |  |  | √   √  √ | √   √  √ |
| Liabilities at fair value through profit or loss (only those held for trading) or rarely meeting other conditions   * Interest bearing liabilities where there is a quoted market price in an active market |  | √ |  |  |  |
| Other Liabilities   * Interest bearing liabilities where market is inadequate (including borrowings from TCV) * Creditors |  |  |  | √  √ |  |
| Derivatives   * Not designated as an accounting hedge * Designated as an accounting hedge – cashflow * Designated as an accounting hedge – fair value |  | √  √ | √ |  |  |
| Embedded derivatives   * Embedded derivatives |  | √ |  |  |  |
| * Embedded derivatives where separation from the host contract is prohibited (see footnote #) |  |  | √ | √ | √ |

* Shares and other equity investments that cannot be reliably measured, are measured at cost (subject to impairment tests).
* Where the embedded derivatives are not separately accounted for from the host contract, it would be measured in accordance with the measurement requirements of the host contract.