CHAPTER 7

# Financial instruments

## INTRODUCTION, SCOPE, DEFINITIONS, RECOGNITION, DERECOGNITION, CLASSIFICATION, INITIAL MEASUREMENT, DERIVATIVES AND EMBEDDED DERIVATIVES AND HEDGE ACCOUNTING

### 7.1.1 Introduction

*No changes to this section*

### 7.1.2 Accounting requirements

#### Definitions

*No changes to this section*

#### Types of financial instruments covered by the chapter

7.1.2.24 A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. The term 'financial instrument' covers both financial assets and financial liabilities and includes both the most straightforward financial assets and liabilities such as trade receivables and trade payables and the most complex ones such as derivatives and embedded derivatives. Typical financial instruments are:

Liabilities

- trade payables and other payables
- borrowings
- financial guarantees.

Assets

- bank deposits
- trade receivables

40. In accordance with IFRS 9 *Basis for Conclusions* BC4.252-3, the adjustment of a financial liability modification (or exchange) that does not result in derecognition is expected to be consistent with the adjustment of the gross carrying value of a financial asset when the financial asset modification does not result in derecognition.

- loans receivable
- other receivables and advances
- investments.

Derivatives

- swaps
- forwards
- options.

Embedded derivatives

- debt instruments with embedded swaps
- debt instruments with embedded options.

### Scope exclusions [Please note 7.1.2.25 has been restructured to align with the order of IFRS 9.]

7.1.2.25 Some types of financial instrument covered by IFRS 9 are not covered in detail by the Code because they are not relevant to entities that do not issue equity instruments. The applicable IFRS shall be followed if circumstances were such that the provisions concerning equity instruments became relevant, for example, in group accounts (see Chapter 9 – Group Accounts). This chapter does not cover the following types of financial instrument since they are within the scope of other accounting standards rather than IFRS 9 and are dealt with elsewhere in the Code. These are:

a) Interests in subsidiaries, associates and joint ventures, which are covered by Chapter 9 – Group Accounts. However, in some cases, IFRS 10 *Consolidated Financial Statements*, IAS 27 *Separate Financial Statements* or IAS 28 *Investments in Associates and Joint Ventures* require or permit an authority to account for an interest in a subsidiary, associate or joint venture in accordance with some or all of the requirements of IFRS 9.

b) In respect of the recognition and measurement provisions of this chapter of the Code, rights and obligations under leases and PFI, PPP and similar schemes, which are covered by Sections 4.2 and 4.3 of the Code, except for lessors' lease receivables with respect to the derecognition and impairment provisions of this chapter; lessees' lease payables with respect to the derecognition provisions; payables under PFI, PPP and similar schemes with respect to the derecognition provisions; and derivatives that are embedded in leases and PFI, PPP and similar schemes. The disclosure requirements of this chapter of the Code apply in full to these transactions and balances.

c) Employers' rights and obligations under employee benefit plans, which are covered by Chapter 6 (Employee Benefits).

d) Rights and obligations arising under an insurance contract as defined in IFRS 17 *Insurance Contracts* other than a financial guarantee contract that meets the definition of a financial guarantee contract under paragraphs 7.2.7.1 to 7.2.7.4 of this chapter of the Code.

e) Any forward contract between an acquirer and a selling shareholder to buy or sell an acquiree that will result in a business combination within the scope of IFRS 3 Business Combinations at a future acquisition date. The term of the forward contract should not exceed a reasonable period normally necessary to obtain any required approvals and to complete the transaction.

f) Loan commitments, unless they can be settled net in cash or there is a past practice of selling the resulting loans shortly after origination or the commitment is to provide at below market interest rate. However, an issuer of loan commitments shall apply the impairment requirements of IFRS 9 to loan commitments that are not otherwise within the scope of IFRS 9. Also, all loan commitments are subject to the derecognition requirements of IFRS 9. Loan commitments are also subject to the disclosure requirements of IFRS 7.

g) Financial instrument contracts and obligations under share-based transactions to which Code Appendix A, paragraph A.1.6 applies, except for contracts within the scope of paragraphs 2.4 to 2.7 of IFRS 9.

h) Rights to receive reimbursement of expenditure required to be made to settle a liability recognised as a provision in accordance with Section 8.2 of the Code, or for which in an earlier period, was recognised as a provision.

i) Rights and obligations within the scope of Section 2.7 and IFRS 15 Revenue from Contracts with Customers that are financial instruments, except for those that Section 2.7 and IFRS 15 specifies are accounted for in accordance with this section of the Code and IFRS 9.

e)~~Contracts to buy or sell non-financial items (for example, commodity futures contracts) unless they can be settled net in cash and are not entered into and held for the purposes of the receipt or delivery of a non-financial item in accordance with the authority's expected purchase, sale or usage requirements.~~

**Contracts to buy or sell non-financial items**

7.1.2.26 IFRS 9 shall be applied to those contracts to buy or sell non-financial items (for example, commodity futures contracts) that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the authority's expected purchase, sale or usage requirements.

7.1.2.27 An authority shall apply paragraphs B2.7–B2.8 of IFRS 9 to assess whether contracts referencing nature-dependent electricity (as described in paragraph 2.3A of IFRS 9) are entered into and continue to be held for the purpose of the receipt of electricity in accordance with the authority's expected usage requirements. An authority shall apply the amendments to IFRS 9 relating to nature-dependent electricity contracts in accordance with the transitional provisions set out in paragraphs 7.2.51–7.2.53 of IFRS 9. They shall also be presented and disclosed in accordance with the requirements of IFRS 7.

~~7.1.2.26~~7.1.2.28 Special considerations apply in respect of receivables and payables arising from non-exchange transactions such as council tax (see Sections 5.2 and 8.1 of the Code).

### 7.1.3 Initial recognition of a financial instrument

*No changes to this section*

### 7.1.4 Derecognition of a financial instrument

#### Derecognition of a financial asset

*No changes to this section*

#### Derecognition of a financial liability

7.1.4.4 An authority shall derecognise a financial liability (or a part of a financial liability) when, and only when, it is extinguished – ie when the obligation specified in the contract is discharged or cancelled or expires. The difference between the carrying amount of a financial liability (or part of a financial liability) extinguished or transferred to another party and the consideration paid including any non-cash assets transferred or liabilities assumed shall be recognised in surplus or deficit on the provision of services.

7.1.4.5 Despite the requirement in paragraph 7.1.4.4 to derecognise a financial liability on the settlement date, IFRS 9 permits an authority to deem the financial liability (or part of it) to be discharged before the settlement date when settling a financial liability (or part of a financial liability) in cash using an electronic payment system. Authorities should refer to paragraphs B3.3.8–B3.3.10 of IFRS 9 for further guidance.

#### Exchange between an existing borrower and lender

*No changes to this section*

### 7.1.5 Classification of financial instruments

*No changes to this section*

### 7.1.6 Initial measurement of financial instruments

7.1.6.1 At initial recognition, an authority shall measure a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

7.1.6.2 The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price (ie the fair value of the consideration given or received, see also Section 2.10 and IFRS 13). If an authority determines that the fair value at initial recognition differs from the transaction price the authority shall account for that instrument at that date in accordance with paragraph B5.1.2A of IFRS 9. Note that the fair value measurement of soft loans is prescribed in paragraphs 7.1.6.4 to 7.1.6.9 below.

7.1.6.3 At initial recognition, an authority shall measure trade receivables at the amount determined by applying IFRS 15 if the trade receivables ~~that~~ do not have a significant financing component (determined in accordance with IFRS 15). ~~at their transaction price (as defined in IFRS 15).~~

#### Soft loans advanced

*No changes to this section*

#### Soft loans made to a subsidiary

*No changes to this section*

#### Soft loans receivable

*No changes to this section*

### 7.1.7 Derivatives and embedded derivatives

*No changes to this section*

### 7.1.8 Hedge accounting

*No changes to this section*

### 7.1.9 Statutory accounting requirements

*No changes to this section*

### 7.10 Disclosure requirements

7.1.10.1 The disclosure requirements for financial instruments are included in Section 7.3 of the Code.

### 7.11 Statutory disclosure requirements

*No changes to this section*

## SUBSEQUENT MEASUREMENT OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

*No changes to this section*

## 7.3 FINANCIAL INSTRUMENTS – DISCLOSURE AND PRESENTATION REQUIREMENTS

### 7.3.1 Introduction

*No changes to this section*

## PART 1 – DISCLOSURES

### 7.3.2 Significance of financial instruments for financial position and performance

An authority shall disclose information that enables users of its financial statements to evaluate the significance of financial instruments for its financial position and performance and the nature and extent of risks arising from financial instruments to which the authority is exposed during the period and at the end of the reporting period, and how it manages those risks. The disclosures required are listed in paragraphs 7.3.2.2–7.3.4.1.

#### Balance Sheet disclosures

#### Categories of financial assets and financial liabilities

7.3.2.2 The carrying amounts of each of the following categories shall be disclosed either in the Balance Sheet or in the notes to the accounts[60]:

a) financial assets measured at fair value through profit or loss

b) financial liabilities at fair value through profit or loss, if any

41. In the unusual circumstances where an authority designates a financial asset or financial liability at fair value through profit or loss or where it undertakes hedging transactions, the carrying amounts of those financial instruments will need to be disclosed separately in accordance with paragraph 8 of IFRS 7.

c) financial assets measured at amortised cost; where material, the carrying amount of soft loans granted by the authority shall be disclosed separately

d) financial liabilities measured at amortised cost

e) financial assets measured at fair value through other comprehensive income, showing separately:

   i) financial assets that are measured at fair value through other comprehensive income in accordance with paragraph 7.1.5.3, and

   ii) investments in equity instruments designated as such upon initial recognition in accordance with paragraph 7.1.5.9.

### Soft loans granted to other bodies

7.3.2.3 Where an authority separately discloses the carrying amount of soft loans granted by the authority, subject to the application of paragraphs 2.1.2.14 to 2.1.2.17 to ensure that material information is not obscured, it shall also disclose:

a) a reconciliation between the opening and closing carrying amounts of the soft loans, including:

   i) nominal value of new loans granted during the period

   ii) the fair value adjustment on initial recognition

   iii) loans repaid during the period

   iv) impairment losses recognised

   v) any increase during the period in the discounted amount arising from the passage of time, and

   vi) other changes

b) nominal value of the loans at the end of the period

c) the purpose and terms of the various types of loans, and

d) valuation assumptions.

### Financial assets or financial liabilities (designated) at fair value through profit or loss

7.3.2.4 In the unusual circumstance where an authority designates a financial asset or a financial liability at fair value through profit or loss it shall provide the disclosures at paragraphs 9, 10, 10A and 11 of IFRS 7 where relevant.

### Investments in equity instruments designated at fair value through other comprehensive income

7.3.2.5 If an authority has designated investments in equity instruments to be measured at fair value through other comprehensive income, as permitted by paragraph 7.1.5.9, it shall disclose for each class of investment:

a) which investments in equity instruments have been designated to be measured at fair value through other comprehensive income

b) the reasons for using this presentation alternative

c) the fair value ~~of each such investment~~ at the end of the reporting period

d) dividends recognised during the period, showing separately those related to investments derecognised during the reporting period and those related to investments held at the end of the reporting period

e) any transfers of the cumulative gain or loss within reserves during the period including the reason for such transfers.

~~e)~~f) the fair value gain or loss presented in other comprehensive income during the period, showing separately the fair value gain or loss related to investments derecognised during the reporting period and the fair value gain or loss related to investments held at the end of the reporting period.

7.3.2.6 If an authority derecognised investments in equity instruments measured at fair value through other comprehensive income during the reporting period, it shall disclose:

a) the reasons for disposing of the investments

b) the fair value of the investments at the date of derecognition

c) the cumulative gain or loss on disposal

~~c)~~d) any transfers of the cumulative gain or loss within reserves during the reporting period related to the investments derecognised during that reporting period.

### Reclassification

7.3.2.7 An authority shall provide the relevant disclosures in paragraphs 12B to 12D of IFRS 7 if it has reclassified any financial assets in accordance with paragraph 7.2.8.1.

### Offsetting financial assets and financial liabilities

7.3.2.8 The disclosures in paragraphs 1) to 4) below supplement the other disclosure requirements of this section of the Code and are required for all recognised financial instruments that are set off in accordance with paragraph 7.3.5.1. These disclosures also apply to recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are set off in accordance with paragraph 7.3.5.1:

1) An authority shall disclose information to enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on the authority's financial position. This includes the effect or potential effect of rights of set-off associated with the authority's recognised financial assets and recognised financial liabilities that are within the scope of paragraph 7.3.2.8 above.

2) To meet the objective in paragraph 1) above, an authority shall disclose, at the end of the reporting period, the following quantitative information separately for recognised financial assets and recognised financial liabilities that are within the scope of paragraph 7.3.2.8 above:

   a) the gross amounts of those recognised financial assets and recognised financial liabilities

   b) the amounts that are set off in accordance with the criteria in paragraph 7.3.5.1 when determining the net amounts presented in the Balance Sheet

   c) the net amounts presented in the Balance Sheet

   d) the amounts subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in paragraph b), including:

      i) amounts related to recognised financial instruments that do not meet some or all of the offsetting criteria in paragraph 7.3.5.1, and

      ii) amounts related to financial collateral (including cash collateral), and

   e) the net amount after deducting the amounts in d) from the amounts in c) above.

The information required by this disclosure shall be presented in a tabular format, separately for financial assets and financial liabilities, unless another format is more appropriate.

3) The total amount disclosed in accordance with paragraph 2 d) for an instrument shall be limited to the amount in disclosure 2 c) for that instrument.

4) An authority shall include a description in the disclosures of the rights of set-off associated with the authority's recognised financial assets and recognised financial liabilities subject to enforceable master netting arrangements and similar agreements that are disclosed in accordance with paragraph 2 d), including the nature of those rights.

If the information required by paragraphs 1) to 4) is disclosed in more than one note to the financial statements, an authority shall cross-refer between those notes.

### Collateral

7.3.2.9 When an authority holds collateral (of financial or non-financial assets) and is permitted to sell or repledge the collateral in the absence of default by the owner of the collateral, it shall disclose:

a) the fair value of the collateral held

b) the fair value of any such collateral sold or repledged, and whether the authority has an obligation to return it, and

c) the terms and conditions associated with its use of the collateral.

It is considered highly unlikely that authorities will pledge collateral, as all securities created by a local authority rank equally without any priority in accordance with Section 13 of the Local Government Act 2003 (in England and Wales) or Regulation 7 of the Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016. If, exceptionally, an authority has pledged collateral, it shall provide the disclosures required by IFRS 7.

### Allowance account for credit losses

7.3.2.10 The carrying amount of financial assets measured at fair value through other comprehensive income in accordance with paragraph 7.1.5.3 is not reduced by a loss allowance and an authority shall not present the loss allowance separately in the Balance Sheet as a reduction of the carrying amount of the financial asset. However, an authority shall disclose the loss allowance in the notes to the financial statements.

### Defaults and breaches

7.3.2.11 For loans payable recognised at the end of the reporting period, subject to the application of paragraphs 2.1.2.14 to 2.1.2.17 to ensure that material information is not obscured, an authority shall disclose:

a) details of any defaults during the period of principal, interest, sinking fund, or redemption terms of those loans payable

b) the carrying amount of the loans payable in default at the reporting date, and

c) whether the default was remedied, or the terms of the loans payable were renegotiated, before the financial statements were authorised for issue.

7.3.2.12 If, during the period, there were breaches of loan agreement terms other than those described in paragraph 7.3.2.11, subject to the application of paragraphs 2.1.2.14 to 2.1.2.17 to ensure that material information is not obscured, an authority shall disclose the same information as required by paragraph 7.3.2.11 if those breaches permitted the lender to demand accelerated repayment (unless the breaches were remedied, or the terms of the loan were renegotiated, on or before the reporting date).

## Comprehensive Income and Expenditure Statement disclosures

### Items of income, expense, gains or losses

7.3.2.13 An authority shall disclose the following items of income, expense, gains or losses either on the face of the financial statements or in the notes[61]:

a) net gains or net losses on:

i) financial assets or financial liabilities at fair value through profit or loss

ii) financial liabilities measured at amortised cost

iii) financial assets measured at amortised cost

iv) investments in equity instruments designated at fair value through other comprehensive income in accordance with paragraph 7.1.5.9

v) financial assets measured at fair value through other comprehensive income in accordance with paragraph 7.1.5.3, showing separately the amount of gain or loss recognised in other comprehensive income and expenditure during the period and the amount reclassified upon derecognition from accumulated other comprehensive income and expenditure to surplus or deficit on the provision of services for the period

b) total interest revenue and total interest expense (calculated using the effective interest method) for financial assets that are measured at amortised cost or that are measured at fair value through other comprehensive income in accordance with paragraph 7.1.5.3 (showing these amounts separately); or financial liabilities that are not measured at fair value through profit or loss

c) fee income and expense (other than amounts included in determining the effective interest rate) arising from:

i) financial assets or financial liabilities that are not at fair value through profit or loss, and

ii) trust and other fiduciary activities that result in the holding or investing of assets on behalf of individuals, trusts, retirement benefit plans, and other institutions.

7.3.2.14 An authority shall disclose an analysis of the gain or loss recognised in the Comprehensive Income and Expenditure Statement arising from the derecognition of financial assets measured at amortised cost, showing separately gains and losses arising from derecognition of those financial assets. This disclosure shall include the reasons for derecognising those financial assets.

7.3.2.15 An authority shall disclose the information required by paragraph 7.3.2.16 by class of financial assets measured at amortised cost or fair value through other comprehensive income and by class of financial liabilities measured at amortised cost. The entity shall consider how much detail to disclose, the appropriate level of aggregation or disaggregation, and whether users of financial statements need additional explanations to evaluate any quantitative information disclosed.

7.3.2.16 To enable users of financial statements to understand the effect of contractual terms that could change the amount of contractual cash flows based on the occurrence (or non-occurrence) of a contingent event that does not relate directly to changes in basic lending risks and costs (such as the time value of money or credit risk), an entity shall disclose:

(a) a qualitative description of the nature of the contingent event;

(b) quantitative information about the possible changes to contractual cash flows that could result from those contractual terms (for example, the range of possible changes); and

(c) the gross carrying amount of financial assets and the amortised cost of financial liabilities subject to those contractual terms.

~~7.3.2.14~~7.3.2.17 For example, an authority shall disclose the information required by paragraph 7.3.2.16 for a class of financial liabilities measured at amortised cost whose contractual cash flows change if the authority achieves a reduction in its carbon emissions.

### Other disclosures

*No changes to this section*

### 7.3.3 Nature and extent of risks arising from financial instruments

*No changes to this section*

### 7.3.4 Transfers of financial assets

*No changes to this section*

## PART 2 – PRESENTATION REQUIREMENTS

*No changes to this section*