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Draft EPSAS Screening Report
IPSAS 30 - Financial instruments: disclosures

Paper by PwC in cooperation with Eurostat
- written consultation -

This document was commissioned by Eurostat. It analyses the consistency of the named IPSAS standard with the draft EPSAS framework, with a view to informing future EPSAS standard setting. This version was prepared taking into account comments received from the participants of the Cell on Principles related to EPSAS Standards.

In advance of the autumn 2020 Working Group meeting, participants are invited to provide written comments on the analysis provided and on the conclusions reached.

Pilot EPSAS screening report

IPSAS 30 - Financial instruments:
Disclosures

March 2020



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Background

Objectives

Reference is made to the general introduction to the pilot EPSAS screening reports that covers the following elements:

- Key objectives of EPSAS.
- Standard setting process in the public sector.
- Purpose and scope of the screening reports.
- Approach of the screening reports.
- European public good.
- Common elements considered when preparing the reports.

General introduction to IPSAS 30

IPSAS 30 is based on International Financial Reporting Standard IFRS 7 'Financial Instruments: Disclosures', issued by the International Accounting Standards Board (IASB). In developing IPSAS 30, the IPSASB applied its 'Process for Reviewing and Modifying IASB Documents' that identifies public sector modifications where appropriate. This approach enables the IPSASB to build on best practices in private sector financial reporting, while ensuring that the unique features of the public sector are addressed.

IPSAS 30 requires disclosure of information about the significance of financial instruments for an entity's financial position and financial performance. These include:

- disclosures relating to the entity's financial position - including information about financial assets and financial liabilities by category, special disclosures when the fair value option is used, reclassifications, de-recognition, pledges of assets, embedded derivatives and breaches of terms of agreements;
- disclosures relating to the entity's performance in the period – including information about recognised revenue, expenses, gains and losses; interest revenue and expense; fee revenue; and impairment losses;
- special disclosures for concessionary loans; and
- other disclosures – including information about accounting policies, hedge accounting and the fair values of each class of financial asset and financial liability.

IPSAS 30 requires disclosure of information about the nature and extent of risks arising from financial instruments:

- qualitative disclosures about exposures to each class of risk and how those risks are managed; and

- quantitative disclosures about exposures to each class of risk, separately for credit risk, liquidity risk, and market risk. Disclosures about liquidity risk include maturity analyses for both non-derivative and derivative liabilities such as issued financial guarantee contracts. Disclosures about market risk include sensitivity analyses.

Main public sector differences between IFRS 7 and IPSAS 30 are summarised below¹:

- IPSAS 30 uses different terminology;
- IPSAS 30 contains requirements related to concessionary loans.

Scope of the report

The present screening report analyses the disclosure requirements applicable to the financial assets and liabilities in the scope of IPSAS 30.

However, the recognition, classification, measurement and (some of the) presentation requirements for financial assets and liabilities are covered in IPSAS 41 'Financial instruments' and are therefore not considered in this report. IPSAS 28 'Financial instruments: presentation' deals with principles for presenting financial instruments as liabilities or net assets/equity and the offsetting requirements.

Reference to EFRAG assessment

EFRAG published its final comment letter to IFRS 7 on 8 November 2004 and its endorsement advice on 5 October 2005.

Based on the requirements of Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards, EFRAG provided an opinion on IFRS 7 'Financial instruments: Disclosures'. EFRAG summarised its conclusions and its endorsement advice to the European Commission as follows:

"EFRAG supports the objective (of IFRS 7) and considers that the Standard achieves it satisfactorily.

EFRAG has evaluated IFRS 7 based on input from standard setters and market participants in accordance with EFRAG's due process. EFRAG supports the issuance of the Standard and has concluded that the Standard meets the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards that:

i. it is not contrary to the 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and

¹ Refer to the IPSAS-IFRS Alignment Dashboard regularly updated by the IPSASB available on https://www.ifac.org/system/files/uploads/IPSASB/Agenda%20Item%201.5%20IPSAS%20IFRS%20Alignment%20Dashboard_June%202019.pdf¹

ii. *it meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.*

For the reasons given above, EFRAG believes that it is in the European interest to adopt IFRS 7 Financial Instruments: Disclosures, and, accordingly, EFRAG recommends its adoption. EFRAG also wishes to bring to your attention the considerable interest around Europe in having IFRS 7 endorsed in time to be available for use in 2005 financial statements, provided that application in 2005 would not be mandatory. That is because some entities may wish to avoid having to change their reporting systems twice in a short period of time from providing disclosures required under IAS 32 Financial Instruments: Disclosures and Presentation and IAS 30 Disclosures in the Financial Statements of Banks and Similar Financial Institutions to disclosure requirements under IFRS 7. Such a change might also be confusing for users of financial statements.”

Further, IFRS 9 amended disclosures in IFRS 7. The key aspects of those amendments included disclosures with regard to:

- (a) initial application of IFRS 9,
- (b) financial assets for which the entity elects to present fair value changes through other comprehensive income,
- (c) reclassification of financial assets between the fair value and amortised cost categories following a change in the business model of an entity, and
- (d) a reconciliation of the gain or loss recognised in the statement of comprehensive income arising from the derecognition of financial assets and financial liabilities measured at amortised cost.

The endorsement Advice on IFRS 9 Financial Instruments (dated 15 September 2015) covered these amended disclosures in IFRS 7, with no significant objections relating to disclosures.

Reference to EPSAS issue paper

An EPSAS issue paper was prepared on the topic of “a principled approach to disclosures”. The paper was issued in May 2018.

In general, the question of improving disclosures in the notes to the financial statements is an essential component of a better communication in financial reporting. In the current context, IPSAS as well as IFRS financial reports and disclosure requirements are frequently considered too complex. This is being driven by several factors:

- the ‘checklist’ approach taken by many current accounting standards, which lists detailed disclosures rather than relying on broad disclosure objectives;
- relevant information being obscured by large amounts of standing data and boilerplate disclosures;
- a strong focus on completeness of disclosures by auditors and regulators alike, which discourages preparers from considering materiality and relevance when preparing their financial statements.

In addition, the Disclosure Initiative launched by the International Accounting Standards Board (IASB) has recently highlighted that the absence of clear disclosure objectives in IFRS standards can make it difficult for entities to:

- understand the purpose of some disclosure requirements;
- apply judgment in deciding what information to disclose and in tailoring disclosures to their own circumstances, as the long lists of prescriptive disclosure requirements reinforce the perception that financial statements are compliance documents.

A PwC study of 2014² analysed the suitability of the IPSAS standards as a basis for developing EPSAS. The PwC study reported that “...*compliance with the extensive disclosure requirements is one of the areas that have been identified by the Member States as requiring the most significant efforts*”. A few of them indicated that IPSAS contain too detailed disclosure requirements and the usefulness of these is sometimes questionable. A limited number of comments have been expressed specifically in relation to IPSAS 30:

“IPSAS 30 ‘Financial instruments: disclosures’ - some Member States express the view that the detailed disclosure requirements of IPSAS 30 go beyond the needs of public sector entities.

The PwC study says that, when material transactions are concluded that involve major risks for governments, appropriate disclosure should be given on these transactions and on the exposure these have created for the public sector entity. Judgment is required in determining information that is relevant for a proper understanding of the transactions and their (potential) impact on the financial position, performance and cash flows of the entity. Keeping these sound principles in mind, the study suggests that a review of (some of) the disclosure requirements of IPSAS 30 might be envisaged in view of the European needs and/or that additional guidance on how to apply these might be provided.”

In response to the above concern and based on the comments received from Member States, the PwC study from 2014 notes that indeed materiality and pragmatism should be considered in applying the new EPSAS requirements to smaller and less risky entities. In addition to this, an EPSAS paper has been developed on the topic to discuss if and how financial reporting requirements could be relaxed for SLRE.

All QC and related constraints are important however we believe some of them are particularly important with respect to the preparation of disclosures. These are the following:

- **Relevance.** The IASB Disclosure Initiative revealed that investors and users of financial statements believe that not enough relevant information yet too much irrelevant information is given in financial statements. Relevance is about providing information which is useful for accountability and decision-making purposes and should be at the heart of the discussions about the design of a principled approach to disclosures.

² See PwC, Collection of information related to the potential impact, including costs, of implementing accrual accounting in the public sector and technical analysis of the suitability of individual IPSAS standards, 2013/S 107-182395, 1 August 2014

- Understandability. The role of information which is disclosed in the notes to the accounts is to provide information in addition to the primary statements (statement of financial position, statement of financial performance, cash flow statement and statement of changes in equity) which complements and helps better understand the information displayed in the primary statements. Understandability is thus a key objective in the preparation of disclosures. The IASB Disclosure Initiative also revealed that how information is presented and communicated may be improved to help users better understand financial statements. Understandability thus has to do with both the content and format of the disclosures.
- Comparability. Comparability of financial information presented by Member States and within Member States is a key objective of the EPSAS project. It should be part of the key disclosure objectives as well.
- Materiality is a very important concept which, when appropriately applied, can add to the relevance of financial information which is disclosed and facilitate the understanding of the financial statements as a whole. It can in addition help address the concern raised by many Member States that preparation of disclosures under IPSAS is burdensome.

No other EPSAS issue paper was prepared on the topic of disclosures related to financial instruments.

Screening of IPSAS 30 ‘Financial Instruments: Disclosures’ against criteria set in the draft EPSAS framework

Introduction

The EPSAS criteria listed in the draft EPSAS framework have been used to perform an assessment of IPSAS 30 ‘Financial instruments: disclosures’ published in January 2010 by the IPSAS board (IPSASB).

First, the paper addresses whether IPSAS 30 would meet the qualitative characteristics of the draft EPSAS CF, i.e. whether it would provide relevant, reliable, complete, prudent, neutral, verifiable, economically substantive, understandable, timely and comparable information and would not be contrary to the true and fair view principle.

This report then considers disclosures requirements applicable to the financial instruments for each of the qualitative characteristics of the draft EPSAS CF.

Further, this paper includes a high-level comparison between the requirements of IPSAS 30 and other international accounting and financial reporting frameworks applied by the public sector entities in various jurisdictions, such as IFRS, ESA 2010 and EU Accounting Rules (AR), bearing in mind the objective of alignment, reduction of cost of implementation and compliance cost.

Finally, the paper assesses whether IPSAS 30 would be conducive to the European public good.

The findings are presented below and the conclusions are included in the next section of this report.

Conformity with Qualitative Characteristics

Relevance

The disclosures presented in the notes and prepared in accordance with the requirements of IPSAS 30 enable users to evaluate the significance of financial instruments for the entity’s financial position and performance, and the nature and extent of risks arising from financial instruments to which the entity is exposed during

the period and at the end of the reporting period, and how the entity manages those risks. The disclosure principles should encourage governments to better apply judgment and communicate information more effectively to users of the financial statements.

The principles in IPSAS 30 complement the principles for recognizing, measuring, and presenting financial assets and financial liabilities in IPSAS 28 'Financial instruments: presentation' and IPSAS 41 'Financial instruments'.

When material transactions are concluded that involve major risks for governments, appropriate disclosure should be given on these transactions and on the exposure these have created for the public sector entity. Judgment is required in determining information that is relevant for a proper understanding of the transactions and their (potential) impact on the financial position, performance and cash flows of the entity.

Information about the financial instruments presented in the notes of an entity is relevant and useful in providing users of financial statements with a basis to assess the ability of the entity to evaluate the significance of financial instruments for the entity's financial position and performance. The economic decisions taken by users require an evaluation of the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks.

Key disclosures include information on:

- classes of financial instruments;
- significance of financial instruments for financial position and financial performance;
- fair value and fair value hierarchy: information on level 1, level 2 and level 3 fair values;
- nature and extent of risks arising from financial instruments.

Qualitative as well as quantitative information should be given on credit risk (including on credit quality of financial assets, on any concentration of credit risk, and on the impact of collaterals obtained), liquidity risk and market risk (including a sensitivity analysis on potential movements in exchange rates, interest rates, etc.).

More specifically, IPSAS 30 helps providing useful and relevant information in the following main area, relevant for financial instrument reporting:

- *Recognition and de-recognition of financial assets and financial liabilities*

Accounting complexity around de-recognition rules of financial assets and financial liabilities requires public sector entities to apply the assessment criteria carefully to the individual material transactions. Professional judgment is needed to determine whether de-recognition criteria are met or not.

In order to enhance the relevance and comparability of the information, appropriate disclosures help understand the practical consequences of the derecognition rules

for financial assets and liabilities, especially as a result of modifications in contractual cash flows.

- *Classification and measurement*

The classification of financial assets is the foundation for the requirements relating to the measurement of financial assets on an ongoing basis, and the requirements for impairment and hedge accounting.

IPSAS 41 ‘Financial instruments’ provides one single approach for the classification of all financial assets. The two criteria used to determine how financial assets should be classified and measured are:

- The entity’s management model for managing the financial assets; and
- The contractual cash flow characteristics of the financial assets.

Entities are also allowed to elect to account for financial assets at fair value through surplus/deficit in some cases, to eliminate an accounting mismatch between financial assets and liabilities. In addition, there is an irrevocable option to present in net assets/equity subsequent changes in the fair value of an investment in an equity instrument that is neither held for trading nor contingent consideration in a public sector combination.

The disclosure requirements of IPSAS 30 related to classes of financial instruments and level of disclosures are relevant because it requires entities to group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. The classes are determined by the entity and are, thus, distinct from the categories of financial instruments specified in IPSAS 41 (which determine how financial instruments are measured and where changes in fair value are recognised).

Moreover, usefulness of the information disclosed in accordance with IPSAS 30 is maximized when only relevant information is kept, and irrelevant information is not obscuring the important information. This is addressed by the chapter AG3 of the Application Guidance of IPSAS 30 as follows: *‘An entity decides, in the light of its circumstances, how much detail it provides to satisfy the requirements of this Standard, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information with different characteristics. It is necessary to strike a balance between overburdening financial statements with excessive detail that may not assist users of financial statements and obscuring important information as a result of too much aggregation. For example, an entity shall not obscure important information by including it among a large amount of insignificant detail. Similarly, an entity shall not disclose information that is so aggregated that it obscures important differences between individual transactions or associated risks.’*

Expected credit loss model

There is a single forward-looking impairment model for the assets not measured at fair value through surplus/deficit that eliminates the threshold for impairment recognition.

The forward-looking model requires an entity to recognise expected credit losses at all times, applying a dual measurement approach based on 12-months expected losses or life-time expected losses. The complexity of this dual approach is partially mitigated by useful practical expedients for certain groups of financial assets (such as assets that result from exchange transactions that are within the scope of IPSAS 9 and non-exchange transactions in the scope of IPSAS 23).

IPSAS 30 provides relevant guidance as it introduces extensive requirements for the disclosure of information related to credit risk management practices, and how they relate to the recognition and measurement of expected credit losses. To meet this objective an entity shall disclose information that enables users of financial statements to understand and evaluate how the credit risk is determined, including when financial instruments are considered to have low credit risk and the presumption that there have been significant increases in credit risk since initial recognition. For example, disclosures are required with respect to if and how financial instruments are considered to have low credit risk including respective classes of financial instruments.

Information also includes the definition of default, the considerations used for grouping instruments, the entity's write-off policy, etc. In addition, an entity shall explain the inputs, assumptions and estimation techniques used to apply the expected credit losses requirements.

Hedge accounting

IPSAS 41 significantly improves the requirements for applying hedge accounting, giving new possibilities in applying this accounting technique (e.g. hedging risk components of non-financial items, net positions, aggregate exposures, layers, etc.) Some other requirements regarding hedge accounting are simplified, (e.g. the hedge effectiveness range of 80-125% in which entities had to fall under the previous standard does not exist any more. Instead, entities set themselves the threshold in line with their own hedging objectives).

For those risk exposures that an entity hedges, and for which it elects to apply hedge accounting, IPSAS 30 requires to provide information about the entity's risk management strategy and how it is applied to manage risk, how the hedging activities might affect the cash flows and the effect of hedge accounting on financial position and performance. That information is therefore relevant.

Faithful representation / Reliability

The disclosures presented in the notes and prepared in accordance with the requirements of IPSAS 30, when used in conjunction with other information included in the financial statements, provides information that enables users to evaluate the significance of financial instruments for the entity's financial position and performance as well as the nature and extent of risks arising from financial instruments to which the entity is exposed during the period, and how the entity manages the risks.

The notion of faithful representation and reliability in the draft EPSAS CF is linked to the qualitative characteristics of completeness, prudence, neutrality, verifiability and substance over form. These are separately discussed below.

More specifically, IPSAS 30 helps providing faithful and reliable information in the following main area, relevant for financial instrument reporting:

SPPI test

The implementation of the cash flow characteristics criterion requires judgment to ensure that financial assets are classified into the appropriate category. To ensure reliability of the information, preparers are required to disclose the significant judgment they applied in performing the SPPI testing.

Fair value option

An irrevocable designation at inception of a financial asset as at fair value through surplus/deficit if it eliminates or significantly reduces an accounting mismatch may bring some limitation to the relevance of the information. Indeed, if the reason for choosing the fair value option disappears, the ongoing fair value measurement may give rise to an accounting mismatch.

However, preparers are required to disclose the significant judgment they applied in taking the decision of applying, or not applying the option, as well as the reasons why it does eliminate potential accounting mismatches. This participates in the maximisation of the faithful representation and reliability of the information disclosed.

In addition, in case of reclassification, IPSAS 30 requires the disclosure of information regarding the date and amount of the reclassification, and the explanation of the changes that lead to the reclassification. For financial assets reclassified out of fair value through surplus or deficit category, information shall be disclosed about the interest rate determined at the date of reclassification and the interest revenue recognised.

Expected credit loss model

An assessment of the significant increase in credit risk takes into consideration only the changes in the risk of a default occurring rather than changes in the amount of expected credit losses. This aligns the assessment of changes in credit risk with the way probabilities of default are generally tracked in practice and provides reliable information about the practices of the holders of the financial assets. The level of

judgment required for recognition of expected credit losses is substantial as the financial information is being prepared taking into account high levels of uncertainty (and is difficult to track back to the source information/assumptions included in the financial models). On the other hand, extensive information related to the inputs, assumptions and estimation techniques used should be disclosed. Reliability of the resulting information is expected to benefit from the extensive disclosures related to the inputs, assumptions and estimation techniques.

The forward-looking approach to impairment using unbiased information about past events, current conditions and forecast economic conditions supported by disclosure requirements is designed to faithfully represent the current financial position rather than smoothing performance over the expected economic cycle. This enhances the reliability of the information.

Investments in unquoted equity securities

All investments in equity instruments, and derivatives over them, are required to be measured at fair value. This includes investments in and derivatives over, unquoted equity instruments that cannot be measured with sufficient degree of reliability. In cases where the fair value measurement is based upon unobservable inputs, disclosures are able to provide the essential information to users. Despite this limitation, the rare cases where fair value cannot be determined are covered by the exception to fair value measurement provided in the standard.

Namely, an entity shall disclose for each class of financial instruments the methods and, when a valuation technique is used, the assumptions applied in determining fair values of each class of financial assets or financial liabilities.

For example, if applicable, an entity discloses information about the assumptions relating to prepayment rates, rates of estimated credit losses, and interest rates or discount rates. If there has been a change in valuation technique, the entity shall disclose that change and the reasons for making it.

Completeness

Providing disclosures required under IPSAS 30, in particular qualitative and quantitative information regarding the management of different types of risks, level of exposure to those risks, hedge accounting and other areas is necessary for user to fully understand transactions of the entity and other events and conditions being depicted.

Quantitative and qualitative disclosures related to risks

In order to understand the nature and extent of exposure to risks arising from financial instruments, IPSAS 30 requires to disclose extensive qualitative and quantitative information related to credit risk, liquidity risk, and market risk.

The qualitative disclosures describe:

- risk exposures for each type of financial instrument;
- management's objectives, policies, and processes for managing those risks;

- changes from the prior period.

The quantitative disclosures provide information about the extent to which the entity is exposed to risk, based on information provided internally to the entity's key management personnel. These disclosures include:

- summary quantitative data about exposure to each risk at the reporting date;
- disclosures about credit risk, liquidity risk, and market risk and how these risks are managed;
- concentrations of risk.

This results in a complete set of disclosures, which allow users to understand the risks that arise from financial instruments in scope of IPSAS 30, which is in line with the prudence principle.

Prudence

Initial recognition of financial instruments measured at fair value

The transaction price is generally considered the best evidence of the financial instrument's initial fair value. However, it is possible for an entity to determine that the instrument's fair value is not the transaction price. In this case, the surplus or deficit on initial recognition is only recognised if fair value is evidenced by a quoted price in an active market for an identical asset or liability (that is, a level 1 input) or based on a valuation technique that uses only data from observable markets. The disclosures required by IPSAS 30 regarding fair value are extensive and include information about the fair values of each class of financial asset and financial liability, along with:

- comparable carrying amounts;
- description of how fair value was determined;
- the level of inputs used in determining fair value;
- reconciliations of movements between levels of fair value measurement hierarchy additional disclosures for financial instruments whose fair value is determined using level 3 inputs including impacts on profit and loss, other comprehensive income and sensitivity analysis;
- information if fair value cannot be reliably measured.

In addition, the fair value of instruments for which the fair value cannot be measured reliably shall not be disclosed.

ECL model

Due to its forward-looking nature, the ECL model broadens the information that an entity is required to consider when it determines its expectation of credit losses. Consequently, more timely information is required about expected credit losses and it provides financial statement users the ability to make better decisions.

The forward-looking impairment model anticipates recognition of impairment losses in case of financial crisis when the risks relating to financial assets increase. The

approach produces relevant information, under the assumption that the expected credit loss valuation techniques and assumptions are disclosed with sufficient details.

Quantitative and qualitative disclosures related to risks

In order to understand the nature and extent of exposure to risks arising from financial instruments, IPSAS 30 requires disclosing extensive qualitative and quantitative information related to credit risk, liquidity risk, and market risk. The qualitative disclosures are further detailed under the QC of “Completeness”.

This results in a complete set of disclosures, which allow users to understand the risks that arise from financial instruments in scope of IPSAS 30, which is in line with the prudence principle.

Sensitivity analysis

For an entity that has an exposure to market risk arising from financial instruments, IPSAS 30 requires disclosure of a sensitivity analysis. Market risk is the risk that the fair value or cash flows of a financial instrument will fluctuate due to changes in market prices. Market risk reflects interest rate risk, currency risk and other price risks. Disclosures about market risk include:

- sensitivity analysis of each type of market risk to which the entity is exposed;
- additional information if the sensitivity analysis is not representative of the entity's risk exposure (for example because exposures during the year were different to exposures at year-end);
- IPSAS 30 provides that if an entity prepares a sensitivity analysis such as value-at-risk for management purposes that reflects interdependencies of more than one component of market risk (for instance, interest risk and foreign currency risk combined), it may disclose that analysis instead of a separate sensitivity analysis for each type of market risk

The disclosure of such information regarding market risk enables users to evaluate the nature and extent of market risk, in line with the prudence principle.

Neutrality

IPSAS 30 requires disclosing information regarding all financial assets and liabilities, and the underlying risks (including market risk, credit risk, and liquidity risk) and provides consistent principles for all classification categories, achieving neutral presentation and disclosures of the inflows and outflows of economic benefits, as well as the risks, and thus the economic reality.

The value at initial recognition is only different from the transaction price if it relies on a quoted price in an active market for an identical asset or liability or based on a valuation technique that uses only the observable market data. This way the possible manipulation is minimised by referencing to the market price that is supposed to be neutral and free from bias.

Verifiability

Fair value information is less verifiable compared to amortised cost, and involves certain assumptions that are not always observable on the market. Disclosures are therefore helpful to maximise the verifiability of the information.

IPSAS 41 do not provide a definition of default. However, it includes a rebuttable presumption (IPSAS 41 para 83) that default does not occur later than 30 days past due unless an entity has reasonable and supportable information to use a more lagging default criterion. As a consequence, the ability to reflect different economic circumstances is expected to lead to comparable information. The disclosure requirements relating to an entity's definitions of default, including the reasons for selecting those definitions are required. Enhancing the entity-specific disclosures will bring operational benefits for entities and insights into the entity's risk management for users and will not negatively affect verifiability and comparability.

In order for users to be able to verify the information, IPSAS 30 requires the disclosure of information related to reclassifications, reconciliations and roll forwards. This is useful in order to understand the differences that occur across periods and categories of instruments. Such disclosures include:

- reclassifications of financial instruments from one category to another (e.g. from fair value to amortised cost or vice versa);
- reconciliation of the allowance account for credit losses (bad debts) by class of financial assets;
- reconciliations of movements between levels of fair value measurement hierarchy additional disclosures for financial instruments whose fair value is determined using level 3 inputs including impacts on profit and loss, other comprehensive income and sensitivity analysis.

Substance over form

IPSAS 30 (as a principle-based standard) is designed to reflect the substance of an economic phenomenon instead of merely providing information about its legal form. In case the legal form differs from the substance of an economic phenomenon, relevant information is provided in order for the users to understand the difference.

The requirements of the standard properly address the need to reflect in a transparent way the substance of the (sometimes complex) financing arrangements, the financial risks that are taken by governments when they enter into significant and risky transactions, including financial guarantees, derivatives, investments in financial institutions or other private entities.

Governments at all levels often incur large amounts of borrowings to fund their activities, including their social programs or the construction of infrastructure assets. The substance of these transactions should be reflected in the financial statements as either financial liabilities or equity instruments.

Based on our assessment, the principle-based disclosure requirements of IPSAS 30 achieve an adequate reflection of risks and the expected cash flows of a broad range

of financial instruments of governments. The increased level of disclosures under IPSAS 30 helps better understand the economic substance of the underlying transactions to confirm that the substance over form principle is respected.

Understandability

The role of information which is disclosed in the notes to the accounts is to provide information in addition to the primary statements (statement of financial position, statement of financial performance, cash flow statement and statement of changes in equity) which complements and helps better understand the information displayed in the primary statements. Understandability is thus a key objective in the preparation of disclosures. The IASB Disclosure Initiative also revealed that how information is presented and communicated might be improved to help users better understand financial statements. Understandability thus has to do with both the content and format of the disclosures.

In accordance with the issue paper on a principled approach to disclosures, information needs should be analysed primarily from the perspective of the users (citizens, finance providers, parliamentarians, public administration, media, etc.), not only from the preparers' perspective. Therefore, providing clarity to users of government financial statements and making financial statements easily understandable by them is essential.

The hedge accounting model significantly reduces the arbitrary rule-based requirements, enabling the alignment of hedge accounting more closely with the risk management practices adopted when hedging financial and non-financial risks. This enables entities to better reflect their risk management practices in their financial statements, with additional disclosures to allow the users to understand the risks the entity faces, the risk management strategies in place and assess the effectiveness of these strategies. Also, the requirement that all disclosures on hedge accounting are concentrated in one place increases the understandability of the information to users.

The complexity of the measurement models of IPSAS 41 do not impair understandability as they are paired with appropriate disclosures required by IPSAS 30. This is assuming that the users have a reasonable knowledge of financial markets. Therefore, IPSAS 30 satisfies the understandability criterion.

Timeliness

As mentioned above under QC 'prudence', the new ECL model takes a forward-looking view to the recognition of credit losses and therefore provides timely information about such losses.

Disclosures linked to market risk provide useful information on the financial position and future financial performance of the entities. For example, sensitivity analysis required for all types of market risk shows what gain or loss could be expected in the future in relation to financial instruments. In other words, IPSAS 30 requires disclosing information, which can be applied for making forward-looking estimates.

Quantitative information linked to impairment provisions (e.g. GDP growth, unemployment rates, and other parameters used in the ECL models). Based on that information, the user can arrive at a conclusion as to whether the impairment loss has been recorded in a timely manner by comparing the mentioned inputs to his own estimates.

Comparability

Comparability of financial information presented by Member States and within Member States is a key objective of the EPSAS project. It should be part of the key disclosure objectives as well.

Classification and measurement of financial assets (investments in debt securities)

There is one single classification and measurement approach for financial assets (covered by 'IPSAS 41: Financial instruments') that reflects the business model for managing these assets and their cash flow characteristics. The classification is not optional and requires the application of the assessment criteria to each individual financial asset.

Both the assessment of the business model criterion and the contractual cash flow criterion require some judgment, therefore introducing some risk of affecting the comparability of the information reported by governments. These requirements however provide a sound and logical basis to distinguish in an entity's financial position basic lending instruments, measured at amortised cost, from other financial instruments that are measured at fair value. Such distinction aims to provide more relevant information to the users of financial statements. Additionally, all the judgments applied shall be disclosed in the notes to the financial statements.

ECL model

Significant levels of complexity in the models that entities must develop could be considered as obstacles to comparability and will require a significant implementation effort. However, the existence of various practical expedients in the ECL model will be very helpful in achieving the right balance between the cost and benefits of implementing the requirements.

A uniform ECL approach brings a uniform calculation basis for impairment applicable to all financial instruments in its scope. This leads to comparable information despite complexity of the requirements and implementation challenges identified by the public sector preparers.

The disclosure of quantitative inputs to the ECL models improves the comparability between entities. For example, the reader can arrive at further conclusions regarding the level of prudence incorporated in the estimate of expected credit losses, and therefore in the statement of financial performance, by comparing the parameters disclosed by different entities.

Application of the principles will inevitably lead to subjective judgments, assessments and estimates. Subjectivity is also introduced by the requirement to use reasonable

and supportable information available without undue cost or effort. Varying levels of sophistication in the models that entities have developed to support these assessments and estimates could be considered as obstacles to comparability. Disclosures that accompany those estimates are however expected to provide users with sufficient insight into the bases for the judgments and estimates used and would therefore support overall an appropriate level of comparability.

Concessionary loans

The complexity and judgment involved in the accounting for concessionary loans may put at risk the comparability QC. This is however justified by greater relevance of the information that is provided.

Alignment with other frameworks

ESA 2010

Alignment with ESA reporting is desirable, to avoid the burden of a dual reporting in the public sector. Differences with ESA 2010 reporting requirements should be avoided where possible, both regarding the scope of entities to be included in the IPSAS scope of reporting and the IPSAS requirements in terms of measurement and disclosures.

Overall, disclosures required under the ESA 2010 are less burdensome than under IPSAS 30. Under ESA 2010, supplementary information is required for some of the financial assets and financial liabilities. For example, nominal value and market value (and the associated flows) should be disclosed for non-performing loans. Classification of debt securities according to outstanding maturity is also suggested by ESA 2010.

IFRS³

IFRS 7 was used as a basis to develop IPSAS 30. The two Standards are very much aligned. Some differences still exist, such as:

- IPSAS 30 uses different terminology.
- IPSAS 30 contains requirements related to concessionary loans

The above guidance is helpful in achieving the objective of comparability between public sector entities without creating unnecessary differences between IFRS and IPSAS.

EU Accounting Rules

EU Accounting Rule (AR) 11 prescribes the accounting treatment of financial instruments and applies to the classification, presentation, recognition and

³ Refer to the IPSAS-IFRS Alignment Dashboard regularly updated by the IPSASB available on https://www.ifac.org/system/files/uploads/IPSASB/Agenda%20Item%201.5%20IPSAS%20IFRS%20Alignment%20Dashboard_June%202019.pdf

measurement of financial instruments as well as to disclosures on financial instruments and the risk management in the context of financial instruments. EU AR 11 is derived from IPSAS 28-30, IPSAS 29 has been superseded by IPSAS 41 (that amended IPSAS 30 accordingly), effective for annual periods beginning on or after 1 January 2022.

European Public Good

Assessing whether IPSAS 30 is conducive to the European public good

The assessment of whether IPSAS 30 would be conducive to the European public good addresses the following items:

- a) Whether the standard will improve financial reporting;
- b) The costs and benefits associated with the standard; and
- c) Whether the standard could have an adverse effect to the European economy, including financial stability and economic growth.

These assessments will allow the EU authorities to draw a conclusion as to whether the standard is likely to be conducive to the European public good.

The analysis revealed no reasons why IPSAS 30 would not be conducive to the European public good:

IPSAS 30 will contribute to improving financial reporting when compared to heterogeneous reporting requirements currently applied in the EU. It will bring a distinct improvement in enabling users to evaluate the significance of financial instruments for the entity's financial position and performance, and the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks. The disclosure principles should encourage governments to better apply judgment and communicate information more effectively to users of the financial statements.

The information needed for the application of IPSAS 30 can be available in a timely manner only if the necessary systems and procedures are in place. Implementation of the disclosure requirements would involve one-off costs and more moderate costs thereafter on preparers. The benefits derived from the improvements should however outweigh the costs. A proportionate pragmatic approach to implementation contributes to this objective.

Conclusion

Assessing IPSAS 30 against the criteria formulated in the draft EPSAS framework

The analysis has not revealed major conceptual issues with IPSAS 30 'Financial instruments: Disclosures' and has not identified any inconsistency between IPSAS 30 and the draft EPSAS framework.

Following the screening analysis summarised in the present report, the future standard setter could consider following conclusions.

The information resulting from the application of IPSAS 30:

- would provide relevant, reliable, complete, prudent, neutral, verifiable, economically substantive, understandable, timely and comparable information needed for making economic decisions and achieving the necessary level of financial transparency and comparability of financial reporting in the European Union;
- would not be contrary to the true and fair view principle; and
- would be conducive to European public good.

However, as mentioned earlier in this paper, concern has been raised over the detail of the disclosure requirements of IPSAS 30 that could be too burdensome and go beyond the needs of public sector entities.

- *Judgment and comparability.* The use of judgment and estimates is inherent in the preparation of financial statements and may to some extent affect the comparability of financial statements.

IPSAS 30 is complex and requires for very detailed disclosures. However, judgment may be applied and only relevant information may be kept, in order to not obscure the information and therefore hinder the quality and understandability of the financial statements as a whole. Taking into account these elements, the future EPSAS standard-setter could develop further guidance on how to avoid information overload while providing relevant information compliant with IPSAS 30 inspired EPSAS. This question is further developed in the issue paper "A principled approach to disclosures".

More particularly, materiality and pragmatism should be considered in applying the disclosure requirements to smaller and less risky entities. The PwC study of 2014 mentions two options that could in theory be envisaged to deal with a differentiated approach for such entities, also referring to the practices in some countries:

- separate accounting rules that are designed specifically for smaller and less risky entities; or

- specific guidance that is provided on how to apply the rules that are applicable to all entities, with specific consideration of the materiality aspects.

Additionally, the chapter AG3 of the Application Guidance of IPSAS 30 addresses the same concern by stating the following: *An entity decides, in the light of its circumstances, how much detail it provides to satisfy the requirements of this Standard, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information with different characteristics. It is necessary to strike a balance between overburdening financial statements with excessive detail that may not assist users of financial statements and obscuring important information as a result of too much aggregation. For example, an entity shall not obscure important information by including it among a large amount of insignificant detail. Similarly, an entity shall not disclose information that is so aggregated that it obscures important differences between individual transactions or associated risks.*"

It is therefore clear that usefulness of the information disclosed in accordance with IPSAS 30 is maximised when only relevant information is kept, and irrelevant information is not obscuring the important information.

The analysis has not identified any adverse effect of the standard to the European economy, including financial stability and economic growth, or any other factors that would mean the standard is not conducive to the European public good.

The future standard setter could consider the conclusions of this assessment and likely net benefit of using the requirements of IPSAS 30 as a starting point in implementing the equivalent EPSAS, considering the need for additional guidance in applying the Standard for smaller and less risky entities.