United Nations

Corporate Guidance

for

International Public Sector Accounting Standards

Financial Instruments

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1 INTRODUCTION

Financial instruments include a wide range of assets and liabilities at the United Nations Secretariat (United Nations) such as cash, term deposits, investments, contributions receivable and accounts payable. In addition Cash Pools (section 5.1), which represent significant portion of the United Nations assets will be within the scope of accounting for financial instrument. The majority of the financial instruments at the United Nations are as follows:

- Cash at bank and petty cash – applicable to all offices that deal with cash operations, including Offices away from Headquarters (OAHs), Regional Commissions (RCs) and Peace Keeping (PK) missions.
- Term deposits – Headquarter (HQ) and local offices / PK missions - where deposits with banks are held to earn interest.
- Assessed contributions receivable – administered by the Contributions team at the United Nations HQ and UNEP.
- Voluntary contributions receivable – administered by the Accounts division together with Substantive Programme Officers.
- Other receivables – relating to exchange revenue.
- Cash Pools – administered by United Nations Treasury at HQ.
- Loans issues by United Nations – Habitat.
- Promissory notes – administered by United Nations Environment Programme (UNEP).
- Carbon credits – administered by United Nations Environment Programme (UNEP).
- Currency forward contracts – administered by United Nations Treasury at HQ.

Financial instruments are addressed in three standards: IPSAS 28: *Financial Instruments: Presentation* ("IPSAS 28"), which primarily deals with classification and presentation of financial instruments into financial asset, financial liabilities and equity and for offsetting financial assets and financial liabilities; IPSAS 29: *Financial Instruments: Recognition and Measurement* ("IPSAS 29"), which primarily contains requirements for recognition and measurement of financial assets, financial liabilities; and IPSAS 30: *Financial Instruments: Disclosures* ("IPSAS 30"), which primarily deals with disclosures that enable evaluation of significance of financial instruments and the nature and extent of risks arising from financial instruments and how these risks are managed by the reporting entity.

The objectives of this document are to present relevant guidance on financial instruments accounting at the United Nations and briefly touch upon certain specific accounting aspects like cash pools, loans at below market rates, carbon credits, impairment of contributions receivable and disclosure requirements under the IPSAS regime. Please refer to section 7.7 for guidance on the risk management disclosures applicable to all the financial statements compiled by the United Nations Secretariat.

IPSAS 28, IPSAS 29 and IPSAS 30 are three of the most complex standards - they are lengthy, use technical language and often take a rule-based approach. This document is not intended to explain every aspect of the

standards on financial instruments. Rather, it summarizes the main challenges that the United Nations would typically encounter and prioritizes and identifies the key issues with financial instruments at the United Nations. This document also provides a very brief explanation to understand certain financial instruments like derivatives (please refer to section 3.5.5), embedded derivatives (please refer to section 9.1) and hedge accounting (please refer section 9.2) in order to know when to consult further.

2 DEFINITIONS

A financial instrument is any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity.

Some of the important concepts associated with the above definition are considered below:

- **Contractual basis:** The rights or obligations that comprise financial assets or financial liabilities are derived from the contractual provisions that underlie them. An example of an item that would not meet the definition of a financial instrument is tax liability, as it is not based on a contract between the United Nations and the tax authority, but arising through statute. Similarly, constructive obligations do not arise from contracts and are not financial liabilities.
- **Comparison with non-financial assets and liabilities:** Pre-paid expenses like subscription of periodicals or insurance premium for which the future economic benefit is the receipt of goods or services, rather than the right to receive cash or another financial asset, are not financial assets. Similarly, items such as liability recognized for deferral of voluntary contribution revenue are not financial liabilities, because the outflow of economic benefits associated with them is not a contractual obligation to pay cash or another financial asset.
- **Contingencies:** Contingencies that may require the payment of cash but do not as yet arise from a contract, such as a contingent receivable or payable for a court judgment, are not financial instruments. However, when those judgments become enforceable and are thereby contractually reduced to fixed payment schedules then a financial instrument exists.

A **financial asset** is any asset that is:	Examples of financial asset at the United Nations
(a) Cash;	• Cash balance; • Bank balance; • Term deposits with initial maturity of less than three months.
(b) An equity instrument of another entity;	United Nations Staff Mutual Insurance Society (UNSMIS) portfolio has certain investments in equity securities, however generally investments in equity instruments are made by the United Nations' Joint Staff Pension Fund. Other than UNSMIS, the United Nations' investments, including those in the Cash Pools, do not include equity instruments.
(c) A contractual right: • To receive cash or another financial asset from another entity; or • To exchange financial assets or financial	• Assessed contributions receivable; • Voluntary contributions receivable; • Exchange revenue receivables; • Term deposits with initial maturity of more than

A **financial asset** is any asset that is:	Examples of financial asset at the United Nations
liabilities with another entity under conditions that are potentially favorable to the United Nations; or	three months; • Loans from the United Nations to third parties; or • Currency forward contract.
(d) A contract that will or may be settled in the United Nations' own equity instruments.	At the date of this Corporate Guidance, the United Nations does not have financial assets of this nature.

A **financial liability** is any liability that is:	Examples of financial liabilities at the United Nations
(a) A contractual obligation: • To deliver cash or another financial asset to another entity; or • To exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the United Nations; or	• Accounts payables; • Borrowings; or • Currency forward contract.
(b) A contract that will or may be settled in the United Nations' own equity instruments.	At the date of this Corporate Guidance, the United Nations does not have financial liabilities of this nature.

A **derivative** is a financial instrument that derives its value from an underlying rate, price, index, or other variable; requires little or no initial net investment; and is settled at a future date.

Some financial instruments and other contracts combine, in a single contract, both a derivative and a non-derivative. The derivative part of the contract is referred to as an '**embedded derivative**'.

At the date of this Corporate Guidance, the United Nations did not have any significant derivative (other than currency forward contracts) or embedded derivative contracts hence this guidance does not focus on identification and accounting for a derivative and embedded derivative, however please refer to section 9.1 for an overview on embedded derivative instruments.

Derecognition is the removal of a previously recognized financial asset or financial liability from the United Nations' Statement of Financial Position.

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability. An incremental cost is one that would not have been incurred if the United Nations had not acquired, issued or disposed of the financial instrument.

An **equity instrument** is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

3 FINANCIAL INSTRUMENTS

3.1 Financial instruments not covered by these policies

Certain financial instruments relevant to the United Nations that are excluded from the financial instrument standard are as follows:

- Rights and obligations under leases (accounted for under IPSAS 13 - Leases) although the financial instrument standard applies to derecognition and impairment of lease receivables;
- Rights and obligations under employee benefit plans (covered by IPSAS 25 - Employee Benefits); and
- Investments in subsidiaries, associates or joint ventures (as dealt with by IPSAS 6 - Consolidated and Separate Financial Statements, IPSAS 7 - Investments in Associates and IPSAS 8 - Interests in Joint Ventures which for periods beginning on or after 1 January 2017, will be superseded by IPSAS 34: Separate Financial Statements, IPSAS 35: Consolidated Financial Statements, IPSAS 36: Investments in Associates and Joint Ventures, IPSAS 37: Joint Arrangements, and IPSAS 38: Disclosure of Interests in Other Entities).

Therefore, the assessment of whether or not the contractual arrangement gives rise to an asset or liability within the scope of these standards will have significant accounting consequences.

Example: Education grant to employees

The United Nations provides annual education grant to its employees. However if the employee fails to provide a supporting voucher / receipt from educational institution the grant has to be returned back to the United Nations.

Analysis: The education grant is in the nature of employee benefit provided to employee conditional upon employee using the grant amount for education purpose. Accounting for education grant should be based on Corporate Guidance Paper # 8 Employee benefits. The advance given to employees is akin to prepaid expenses and thus does not qualify as a financial instrument.

3.2 Classification of financial instruments

The United Nations classifies all financial assets and financial liabilities into specific categories, in accordance with IPSAS 29. The need to classify financial instruments into specific categories arises from the mixed measurement model, under which some financial instruments are carried at amortized cost whilst others are carried at fair value. Consequently, a particular financial instrument's classification (carried out at initial recognition) drives the subsequent accounting treatment. The standard prescribes four categories for financial assets and two categories for financial liabilities.

Categories of Financial Assets	Categories of Financial Liabilities
i. Fair value through surplus or deficit	i. Fair value through surplus or deficit
ii. Loans and receivables	ii. Other financial liability
iii. Held-to-maturity	
iv. Available-for-sale	

3.2.1 FINANCIAL ASSETS AND FINANCIAL LIABILITIES AT FAIR VALUE THROUGH SURPLUS OR DEFICIT

This category covers:

- Financial assets and financial liabilities designated as being at fair value through surplus or deficit. The United Nations may opt to designate a financial asset or liability into this category only in the following three circumstances.

    1) A group of financial assets, financial liabilities or both is managed and its performance is **evaluated on a fair value basis**, in accordance with a **documented risk management or investment strategy**. The designation should be based on the manner in which the United Nations manages and evaluates performance, rather than on the nature of those financial instruments. All eligible financial instruments that are managed and evaluated together are designated under this category. Designation under this criterion must meet the following two requirements:

        - The financial instruments are managed and performance evaluated on a fair value basis in accordance with a documented risk management or investment strategy; and
        - Information about the group is provided internally on that basis to the United Nations' key management (for example, an Investment Committee or the General Assembly).

    2) The designation eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise. This designation is currently not used by the United Nations.

    3) The item proposed to be designated at fair value through surplus or deficit is a hybrid contract that contains one or more embedded derivatives[1] under certain situations. Currently, the United Nations has not identified any hybrid contracts with material embedded derivatives.

    Example - Investments by the Cash Pool

    The investments in the Cash Pool funds may be classified into this category if the United Nations Treasury monitors and reports its investments on a fair value basis and the information is

[1] **Note** – An embedded derivative is 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 standalone derivative.

periodically reviewed by the management team. Currently the United Nations manages and reports Cash Pool investments on a fair value basis other than the term deposits. The assessment carried out by the United Nations is summarized in following table:

Investment	Fair value through surplus and deficit
Bonds – Government agency	Yes
Bonds – Non-United States	Yes
Bonds –United States Treasury notes	Yes
Discounted securities	Yes
Term deposits – Less than 3 months	Classified as cash and cash equivalent
Term deposits – Greater than 3 months	Yes

- Financial assets and financial liabilities held for trading. A financial asset or liability is held-for-trading if it is:
    - Acquired or incurred principally for the purpose of selling or repurchasing it in the near-term;
    - On initial recognition, part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit taking; or
    - A **derivative** (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).

Currently the United Nations has not identified any financial instrument other than currency forward contract that meets the criteria for held for trading classification.

3.2.2 LOANS AND RECEIVABLES

This category covers non-derivative financial assets with fixed or determinable payments. To be included in this category, a loan or receivable asset must **not be quoted on an active market** and the United Nations must not have **elected to classify** it as being at fair value through surplus or deficit or as an available-for-sale asset. In addition, there must be no intention to sell it in the short term (otherwise the asset would be categorized as held for trading instead) or if the initial investment might not be recovered substantially, other than because of credit deterioration (otherwise the asset would be categorized as available-for-sale).

Example of loans and receivables financial assets at the United Nations:

- Cash and cash equivalents
- Voluntary contribution receivable
- Assessed contribution receivable
- Term deposits with original maturity over three months could be in this category under certain situations**

** Term deposits cannot be classified as fair value through surplus or deficit if they are not managed on a fair value basis. If the option to classify term deposits as available-for-sale is not opted, term deposits will be classified as loans

Loans and receivables from non-exchange transactions typically arise from assessed contributions receivable and donor agreements. Loans and receivables from exchange transactions typically arise when the United Nations provides money, goods or services with no intention of trading the receivable. Examples include receivables relating to the sale of assets, term deposits and loans granted. Investments in debt securities that are quoted in a non-active market can also be classified as loans and receivables.

3.2.3 HELD-TO-MATURITY INVESTMENTS

These are non-derivative financial assets that have fixed or determinable payments and that the United Nations has a positive intention and ability to hold to maturity. Held-to-maturity (HTM) investments are other than:

- Those instruments initially designated as fair value through surplus or deficit (section 3.2.1 above); or
- Those which meet the definition of loans and receivables (section 3.2.2 above); or

Those classified as available-for-sale (section 3.2.4 below). To determine whether the United Nations has a positive intention to hold to maturity an investment in a financial asset with a fixed maturity, the United Nations will have to assess its intention to sell the financial asset (other than if a situation arises that is non-recurring and could not have been reasonably anticipated by the United Nations) in response to changes in market interest rates or risks, liquidity needs, changes in the availability of and the yield on alternative investments, changes in financing sources, and terms or changes in foreign currency risk.

The United Nations will not be able to classify any financial assets as HTM if it has sold or reclassified more than an insignificant amount of HTM investments in current or preceding two financial years unless due to specific circumstances. In such a case, the asset would be classified as available-for-sale and measured at fair value.

At the date of this Corporate Guidance, the United Nations does not expect to classify any of its investment under this category as the United Nations sells its investments based on market circumstances and liquidity needs. Historically the United Nations have sold its investments prior to maturity.

3.2.4 AVAILABLE-FOR-SALE FINANCIAL ASSETS

These are non-derivative financial assets that are **designated** as available-for-sale (AFS) or are **not classified as**:

- Financial assets at fair value through surplus or deficit (section 3.2.1 above);
- Loans and receivables (section 3.2.2 above); or

Held-to-maturity investments (section 3.2.3 above). Examples of available-for-sale financial assets that are likely to be included in this category are:

- Equity investments that are not designated on initial recognition as at fair value through surplus or deficit; or

Currently the United Nations does not expect to classify any of its financial assets under this category.

- Financial assets that could have been classified as loans and receivables on initial recognition, but the United Nations chose to designate as available-for-sale at initial recognition.

3.2.5 OTHER FINANCIAL LIABILITIES

These represent all financial liabilities other than those carried at fair value through surplus or deficit.

Example of other financial liabilities at the United Nations includes accounts payable.

3.3 Initial recognition of financial instruments

The previous section dealt with the definition of financial instruments and their classification. This section covers the recognition of financial assets and financial liabilities by the United Nations in its financial statements.

The rights or obligations that comprise financial assets or financial liabilities are derived from the contractual provisions that underlie them. As a result, the United Nations only recognizes a financial asset or a financial liability at the time it becomes a party to a contract.

Example – Trade date accounting

On 29 December 2013 the United Nations enters into a contract to buy a bond from a regulated exchange. As per the settlement mechanism the United Nations will get the bond on 2 January 2014.

Analysis:

In many regulated financial markets, a settlement mechanism exist under which transactions in financial instruments (particularly quoted equities and bonds) entered into on a particular date are settled a few days after this transaction date.

The date on which the transaction is entered into is called the '**trade date**'. It is the date on which the United Nations commits to purchase or sell an asset. The date on which the transaction is settled by delivery of the underlying asset is called the 'settlement date'.

For example, the standard settlement periods on the London Stock Exchange for equity market securities are trade date plus 3 business days (T+3).

The United Nations made a policy choice to account for the transactions on the trade date; accordingly the bond will be recorded on 29 December 2013.

Example - Firm commitments to buy or sell non-financial assets with payment term of 120 days

The United Nations enters into a contract on 28 December 2013 to buy an item of Property, Plant and Equipment (PPE) to be delivered on 15 January 2014 and paid on 16 May 2014. The PPE was delivered on 16 January 2014.

Analysis:

When the United Nations enters into a firm commitment to purchase a non-financial asset in the future, it does not have the contractual rights that comprise the asset. This means that the United Nations cannot use that asset, or sell it, or pledge it as collateral until the contract matures and the underlying asset is acquired.

Therefore, assets to be acquired and liabilities to be incurred as a result of a firm commitment to purchase or sell goods or services are generally not recognized as assets or liabilities until at least one of the parties has performed under the agreement.

Accordingly, the item of PPE will be recognized as PPE on 16 January 2014 with a corresponding account payable (financial liability).

3.4 Initial measurement of financial instruments

When a financial asset or financial liability is recognized initially, the standard requires that the United Nations measures it at its 'fair value' plus, in certain situations, transaction costs.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable willing parties in an arm's length transaction. The concept of fair value and requirements for determining the fair value of financial instruments are discussed in detail in section 4.

Given that fair value is the price that arm's length market participants would pay or receive in a routine transaction under the market conditions at the date at which the asset or liability is to be measured for accounting purposes (the measurement date), it follows that a financial instrument's initial fair value will normally be the transaction price, that is, the fair value of the consideration given or received.

Example (continued) - Firm commitments to buy or sell non-financial assets with payment term of 120 days

The United Nations enters into a contract on 28 December 2013 to buy an item of PPE for $500,000 to be delivered on 15 January 2014 and paid on 16 May 2014. The PPE was delivered on 16 January 2014.

Analysis: As a pragmatic measure, the standard permits short-term receivables and payables to be measured at the original invoice amount if the effect of discounting is immaterial; management has assessed that the fair value approximates the consideration received and accordingly recognized a payable on 16 January 2014 of $500,000.

Example - Amounts of multi-year contributions are not specific to a certain year

As of 1 January 2015, a United Nations reporting entity enters into an unconditional voluntary contribution agreement with a donor, which provides the reporting entity with funds to support the United Nations' objectives over a two-year period. The agreement is binding on both parties. The market rate of interest to this individual for a two year loan with payment of interest at maturity is 5%. As per the agreed payment schedule, the United Nations will receive $10 million at the end of each year.

Analysis:

When the agreement becomes binding, the United Nations recognizes an asset (a receivable) and revenue. The resources meet the definition of a financial asset and satisfy the recognition criteria when the agreement becomes binding.

Financial instruments are measured at fair value on initial recognition. Accordingly the time value of money should be factored while calculating the value of asset.

The consideration consists of two assets:

- The fair value of receivable, that is $\$10 / (1.05)^1 + \$10 / (1.05)^2 = \$18.59$ million
- The difference of $1.41 million will be accounted as non-investment interest income

NOTE: The following schemes of entries are necessary if the impact of present value is material to the receivable. Refer to section 4.2.2.1 for guidance of appropriate market rate to calculate fair value and Case study on Global Environment Facility Trust Fund in section 7.2.1 of Corporate Guidance #5 Funding arrangements for a multi-year conditional donor agreement.

Journal entries:

1-Jan-15	Dr	Voluntary contribution receivable	18.59	
	Cr	Voluntary contribution revenue		18.59
31-Dec-15	Dr	Voluntary contribution receivable	0.93	
	Cr	Non-investment interest income		0.93
31-Dec-15	Dr	Bank	10.00	
	Cr	Voluntary contribution receivable		10.00
31-Dec-16	Dr	Voluntary contribution receivable	0.48	
	Cr	Non-investment interest income		0.48
31-Dec-16	Dr	Bank	10.00	
	Cr	Voluntary contribution receivable		10.00

Example – Interest free loan to an employee

The United Nations grants an interest free loan of $1,000 to its employee for a period of two years in accordance with its policy. The market rate of interest to this individual for a two year loan with payment of interest at maturity is 10%.

Analysis:

The consideration given to the employee consists of two assets:

- The fair value of the loan, that is $\$1,000 / (1.10)^2 = \$826$
- The difference of $174 that is accounted for as employee compensation.

NOTE: The impact of present value on employee loans is not expected to be material to the financial statements of the United Nations accordingly journal entries have not been prescribed for interest free loans to employees.

For instance ESCWA provides rental advance to staff which is subsequently recovered from staff through salary deduction over one year. In this situation the interest free loan is for less than a year hence the impact of discounting has been deemed immaterial by the United Nations.

3.4.1 TRANSACTIONS COSTS

Transaction costs are **incremental costs** that are directly attributable to the acquisition or issue or disposal of a financial asset or financial liability.

Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisers, brokers and dealers, levies by regulatory agencies and securities exchanges and transfer taxes and duties.

Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

The United Nations accounts for transaction costs in a financial instrument's initial measurement as follows:

Sr. No.	Category of financial asset or liability	Accounting for transaction costs
1	Financial instruments measured at fair value through surplus or deficit	Transaction costs are immediately **recognized in Statement of Financial Performance** on initial recognition
2	Financial assets or financial liabilities not measured at fair value through surplus or deficit i.e. includes financial instruments carried at amortized cost and AFS financial assets	**Added to the initial fair value** i.e. for financial assets, such costs are added to the amount originally recognized and financial liabilities, such costs are deducted from the amount originally recognized

Note: Transaction costs expected to be incurred on a financial instrument's transfer or disposal are not included in the financial instrument's initial measurement.

Example – Initial measurement – Transaction cost - Instrument designated as at fair value through surplus or deficit

The United Nations acquires a financial asset designated at fair value through surplus or deficit at its fair value of $100. Purchase commission of $2 is also payable. At the end of the financial year, the asset's quoted market price is $105. If the asset were to be sold, a commission of $1 would be payable.

Analysis:

As the asset is classified initially at fair value through surplus or deficit, the United Nations recognizes the financial asset at its fair value of $100 and does not includes the purchase commission of $2, which is recorded in the Statement of Financial Performance as expense. At the end of the financial year, the asset is recorded at $105 without regard to the commission of $1 payable on sale. The change in fair value of $5 ($105-$100) is recognized in Statement of Financial Performance resulting in a net gain of $3($5-$2).

Example – Initial measurement – Transaction cost – Instrument designated as AFS

An entity acquires an available-for-sale financial asset at its fair value of $100. Purchase commission of $2 is also payable. At the end of the financial year, the asset's quoted market price is $105. If the asset were to be sold, a commission of $1 would be payable.

Analysis:

As the asset is not classified initially at fair value through surplus or deficit, the entity recognizes the financial asset at its fair value including the purchase commission, that is, at $102. At the end of the financial year, the asset is recorded at $105 without regard to the commission of $1 payable on sale. The change in fair value of $3 ($105-$102) is recognized in net assets.

3.5 Subsequent measurement of financial instruments

Following their initial recognition, financial instruments' classification determines how the financial assets and financial liabilities are subsequently measured in the United Nations' financial statements. The following table summarizes the United Nations' accounting for financial assets, covered in detail in the remainder of this section.

Classification	Financial asset	Measurement basis	Changes in carrying amount	Impairment test	Refer to Section
At fair value through surplus or deficit	Debt	Fair value	Statement of Financial Performance	No [5]	3.5.3
	Equity	Fair value	Statement of Financial Performance	No [5]	3.5.3
	Derivatives [6]	Fair value	Statement of Financial Performance	–	3.5.5. Not discussed in detail as the United Nations does not have significant derivatives other than foreign currency forward contracts.
Loans and receivables	Debt	Amortized cost	Statement of Financial Performance [3]	Yes	3.5.2
Held-to-maturity investments	Debt	Amortized cost	Statement of Financial Performance [3]	Yes	Not discussed in this paper as financial assets are not expected to be classified in this category
Available-for-sale financial assets	Debt	Fair value	Net Assets [2] Statement of Financial Performance [3]	Yes	3.5.4 and 9.3
	Equity	Fair value (Cost [1])	Net Assets [2] Statement of Financial Performance [4]	Yes	Not discussed in this paper as the United Nations does not expect to classify equity investments as Available-for-sale

Notes to the table:

1 Equity instruments that do not have any quoted market price in an active market and whose fair value cannot be reliably measured. Such instruments cannot be classified at fair value through surplus or deficit.

2 Change in fair value including related foreign exchange differences other than those noted in note 3 or 4 below where relevant.

3 Interest calculated using the effective interest method, foreign exchange differences, impairment and reversal of impairment, where relevant, are taken to Statement of Financial Performance.

4 Dividends and impairment are taken to Statement of Financial Performance. Foreign exchange difference on (non-monetary) equity AFS investments taken to net assets and recycled to Statement of Financial Performance on disposal or impairment.

5 Any impairment will be taken though Statement of Financial Performance as part of the change in fair value and so separate impairment testing is not necessary.

6 Includes derivatives not designated as effective hedging instruments.

3.5.1 EFFECTIVE INTEREST RATE METHOD AND AMORTIZED COST

Effective interest method is used by the United Nations for subsequent accounting of loans and receivables, held-to-maturity and available-for-sale debt securities for recognition of interest income.

The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period.

The method's key features are as follows:

- The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the financial instrument's expected life or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. The effective interest rate is essentially the internal rate of return of the financial asset or liability for that period. The internal rate of return can be calculated using a financial calculator or the internal rate of return (IRR) function in a spreadsheet.
- The effective interest method uses a set of estimated future cash flows through the expected life of the financial instrument using all the financial instrument's contractual terms (for example, pre-payment, call and similar options but not future credit losses), rather than contractual cash flows. However, the financial instrument's expected life cannot exceed its contracted life.
- The calculation should include all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts.

The amortized cost of a financial asset or financial liability is as follows:

- The amount at which the financial asset or financial liability is measured at initial recognition;

- **Minus** principal repayments;
- **Plus or minus** the cumulative amortization using the 'effective interest method' of any difference between that initial amount and the amount payable at maturity; and
- **Minus** any reduction (directly or through the use of an allowance account) for impairment or uncollectibility.

Example: Effective interest rate method and amortized cost

Situation A: On 1 January 2013, the United Nations makes a 3 year bank term deposit of $100 at market prevalent terms. A 10% interest is payable at the end of every year.

Situation B: On 1 January 2013, the United Nations makes a 3 year bank term deposit of $100 at market prevalent terms. A 10% interest is payable at the end of every year. The United Nations incurred stamp duty and other direct transaction costs of $5 and received $8 from bank as reimbursement for charges incurred by the United Nations.

Analysis:

<table>
<tr><td>Situation A</td><td>Situation B</td></tr>
<tr><td>Effective interest can be computed in excel by using IRR function:</td><td>Effective interest can be computed in excel by using IRR function:</td></tr>
<tr><td>Outflow on 1 January 2013 – 100 (principal)
Inflow on 31 December 2013 – 10 (interest for year 1)
Inflow on 31 December 2014 – 10 (interest for year 2)
Inflow on 31 December 2015 – 110 (interest and principal)
IRR – 10%</td><td>Outflow on 1 January 2013 – 97 (100+5-8)
Inflow on 31 December 2013 – 10 (interest for year 1)
Inflow on 31 December 2014 – 10 (interest for year 2)
Inflow on 31 December 2015 – 110 (interest and principal)
IRR – 11.23%</td></tr>
<tr><td>Amortized cost schedule:
<table><tr><th></th><th>Year 1</th><th>Year 2</th><th>Year 3</th></tr><tr><td>Opening balance</td><td>100</td><td>100</td><td>100</td></tr><tr><td>Interest income</td><td>10</td><td>10</td><td>10</td></tr><tr><td>Cash received</td><td>(10)</td><td>(10)</td><td>(110)</td></tr><tr><td>Closing balance</td><td>100</td><td>100</td><td>-</td></tr></table></td><td>Amortized cost schedule:
<table><tr><th></th><th>Year 1</th><th>Year 2</th><th>Year 3</th></tr><tr><td>Opening balance</td><td>97.00</td><td>97.90</td><td>98.90</td></tr><tr><td>Interest income</td><td>10.90</td><td>11.00</td><td>11.10</td></tr><tr><td>Cash received</td><td>(10.00)</td><td>(10.00)</td><td>(110.00)</td></tr><tr><td>Closing balance</td><td>97.90</td><td>98.90</td><td>-</td></tr></table></td></tr>
</table>

3.5.2 LOANS AND RECEIVABLES

At initial recognition, loans and receivables instruments are measured at **fair value plus transaction costs** directly attributable to the acquisition or issuance.

Subsequently loans and receivables are measured at **amortized cost using the effective interest method**.

If there is **objective evidence** that an impairment loss on loans and receivables carried at amortized cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset will be reduced either directly or through the use of an allowance account. The amount of the loss will be recognized in surplus or deficit.

Refer to section 3.6 for guidance on impairment of financial assets.

Example: Effective interest rate method and amortized cost

On 1 January 2013, the United Nations makes a 3 year bank term deposit of $100 at market prevalent terms. A 10% interest is payable at the end of every year. The United Nations incurred stamp duty and other direct transaction costs of $5 and received $8 from the bank as reimbursement for charges incurred by the United Nations.

Analysis:

Step 1: Classification

The deposit from the United Nations will be classified as loans and receivables as it is an unquoted term loan with fixed and determinable payment terms and the initial investment is expected to be fully recovered at maturity. Further, the deposit is not intended for trading or designated at fair value through surplus or deficit or available-for sale.

Step 2: Initial recognition and measurement

The deposit will initially be recognized at $97 which is the fair value net of the transaction costs directly attributable to the deposit.

Step 3: Subsequent recognition and measurement

The deposit will subsequently be accounted at amortized cost by applying the effective interest method.

Effective interest rate can be computed in excel by using IRR function:

Outflow on 1 January 2013 – 97 (100+5-8)
Inflow on 31 December 2013 – 10 (interest for year 1)
Inflow on 31 December 2014 – 10 (interest for year 2)
Inflow on 31 December 2015 – 110 (interest and principal)
IRR – 11.23%

Amortized cost schedule:

	Year 1	Year 2	Year 3
Opening deposit balance	97.00	97.90	98.90
Interest income	10.90	11.00	11.10
Cash received	(10.00)	(10.00)	(110.00)
Closing deposit balance	97.90	98.90	-

Accounting entries:

1-Jan-13

Dr	Bank deposit	100.0	
Cr	Unamortized transaction cost		3.0
Cr	Bank		97.0

Interest income for Year 1

Dr	Accrued interest	10.0	
Dr	Unamortized transaction cost	0.9	
Cr	Interest Income		10.9

Interest received at end of Year 1

Dr	Bank	10.0	
Cr	Accrued interest		10.0

Interest income for Year 2

Dr	Accrued interest	10.0	
Dr	Unamortized transaction cost	1.0	
Cr	Interest Income		11.0

Interest received at end of Year 2

Dr	Bank	10.0	
Cr	Accrued interest		10.0

Interest income for Year 3

Dr	Accrued interest	10.0	
Dr	Unamortized transaction cost	1.1	
Cr	Interest Income		11.1

Loan and Interest received at end of Year 3			
Dr	Bank	110.0	
Cr	Accrued interest		10.0
Cr	Bank deposit		100.0

Note: There is no specific guidance in the standard as to how transaction costs incurred in originating or acquiring a floating rate instrument should be amortized. Any methodology that provides a reasonable basis of amortization over the instruments expected life may be used. For example, amortize the fees and costs by reference to the interest rate at inception ignoring any subsequent changes in rates or to adopt a straight-line amortization method.

3.5.3 FINANCIAL ASSETS AT FAIR VALUE THROUGH SURPLUS OR DEFICIT

Upon initial recognition, financial assets through surplus and deficit are measured at **fair value excluding transaction costs**, which are expensed.

After initial recognition, the United Nations measures the instruments held at fair value through surplus or deficit at their **fair values**, without any deduction for transaction costs it may incur on sale or other disposal.

Example - Equity investment at fair value through surplus or deficit

Background:

On 29 December 2015, the United Nations commits to purchase exchange traded fund (ETF) with underlying equity investment for $1,000, which is its fair value on commitment (trade) date. Transaction costs are $1. On 31 December 2015 (financial year-end) and on 4 January 2016 (settlement date) the fair value of the asset is $1,002 and $1,005, respectively. Investment in ETF was sold on 31 January 2016 for $1,010.

Trade date:	29 December 2015 -	$1,000
Reporting date:	31 December 2015 -	$1,002
Derecognition date (sale)	31 January 2016 -	$1,010
Transaction costs on purchase:	$1	

Investment in ETF is classified as fair value through surplus or deficit by the United Nations.

Accounting entries:

At initial recognition (trade date): To record the initial value of the financial asset and transaction costs.

Dr	Financial assets at fair value (Asset)	$1,000	
Dr	Transaction costs (Expense)	$1	
Cr	Payable (Liability)		$1,001

At reporting date (fair value has increased to $1,002): To record the change in fair value of the financial asset.

Dr	Financial asset at fair value (Asset)	$2	
Cr	Net changes in fair value (Gain)		$2

Payment of consideration: To record settlement of purchase price and transaction cost

Dr	Payable (Liability)	$1001	
Cr	Bank (Asset)		$1001

At derecognition: To record sale of ETF

Dr	Bank or receivable (Asset)	$1,010	
Cr	Financial asset at fair value (Asset)		$1,002
Cr	Net changes in fair value (Gain)		$8

Note: IPSAS accounting is based on trade date hence the fair value at settlement date is not relevant.

Refer to section 4 "Fair value" for guidance on fair value determination.

3.5.4 AVAILABLE-FOR-SALE FINANCIAL ASSETS

Upon initial recognition, the available-for-sale financial assets are measured at **fair value, after including the transaction costs** that are directly attributable to the acquisition of the financial assets. All gains and losses arising from changes in **fair value** are subsequently recognized in net assets.

Refer to Annexure 9.2 for an example on measurement of debt instruments classified as available-for-sale.

3.5.5 DERIVATIVES

A derivative is a financial instrument or other contract with all of the following characteristics:

(i) Its **value changes** in response to the change in a specified **interest rate** (LIBOR), **financial instrument price** (the price of an XYZ entity equity share listed on a regulated market), **commodity price** (the price of a bushel of wheat), **foreign exchange rate** (€/$ spot rate), **index of prices** or rates (FTSE 100, a retail price index), **credit rating or credit index** (Moody's credit rating), or other variable, provided in the case of a non-financial variable (a climatic or geological condition such as temperature, rainfall, or earthquake severity) that the variable is not specific to a party to the contract (sometimes called the 'underlying');

(ii) It requires **no initial net investment** or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors. Professional judgment is required as it does not necessarily mean insignificant in relation to the overall investment. It is a relative measure and needs to be interpreted with care. This

reflects the inherent leverage features typical of derivative instruments compared to the underlying instruments; and

(iii) **It is settled at a future date** - All derivatives are settled at a future date. A derivative can be settled net in cash (that is, the entity has the right to receive or the obligation to pay a single net amount) or gross in cash/other financial asset (exchange of cash/other financial asset).

Examples of derivative:

Derivative	Underlying	Notional amount	Settlement amount
Stock options	Market price of share	Number of shares	(Market price at settlement − Strike Price) × Number of shares
Currency forward	Currency rate	Number of currency units	(Spot rate at settlement − Forward rate) × number of currency units
Commodity future	Commodity price per unit	Number of commodity units	Net settlement occurs daily and is determined by the change in the futures price and discounted to reflect the time to maturity
Interest rate swap	Interest rate index	Amounts in C ’s	Net settlement occurs periodically throughout the contract's term based on the formula

Derivatives are financial instruments that are held at fair value and, except for certain situations, fair value changes are accounted through surplus or deficit. Derivatives must be re-measured (at fair value) at each period end.

A gain or a loss arising from a change in the fair value of a derivative asset or liability must be recognized immediately in the Statement of Financial Performance, except for certain situations.

3.5.5.1 Currency Forward Contracts

The United Nations has recently entered into currency forward contracts to reduce exposures to foreign currency fluctuations of certain budgeted expenditure denominated in currencies other than USD.

Foreign currency forward contracts are used as a hedge against currency risk when there is an obligation / expectation to either make or take a foreign currency payment at some point in the future. By locking into a forward contract to sell a currency, the seller sets a future exchange rate with no upfront cost. For example, The United Nations signs a contract today to receive voluntary contribution from a French donor. The terms of the contract require the donor to pay euros in six months' time. The United Nations now has a known euro receivable. Over the next six months, the dollar value of the euro receivable will rise or fall depending on fluctuations in the exchange rate. To mitigate this uncertainty about the direction of the exchange rate, the United Nations may elect to lock in the rate at which it will sell the euros and buy dollars in six months. To accomplish this, the United Nations hedges the euro receivable by locking in a forward.

Contracts can be:

- Currency **forwards** contracts may have different contract sizes, time periods and settlement procedures than futures contracts. Foreign currency forwards contracts are considered over-the-counter (OTC) because there is no centralized trading location and transactions are conducted directly between parties via telephone and online trading platforms.

Currency **futures** contracts have standard contract sizes, time periods, settlement procedures and are traded on regulated exchanges throughout the world. Refer to case study in Section 8.3 for accounting of currency forward contract.

3.6 Impairment of financial assets

A financial asset measured at amortized cost is impaired when its carrying value exceeds the present value of the future cash flows discounted at the financial asset's original effective interest rate. A financial asset that is carried at fair value through surplus or deficit does not give rise to any impairment issues as diminution in value due to impairment is already reflected in the fair value and, hence, in the Statement of Financial Performance.

For the United Nations, impairment issues are primarily relevant to financial assets that are carried at amortized cost. Since the United Nations does not expect to classify its financial instruments as available-for-sale, impairment issues regarding available-for-sale financial assets whose fair value changes are recognized in net assets are not elaborated in this document.

Impairment of financial assets measured at amortized cost is assessed through a two-step process.

3.6.1 STEP 1: OBJECTIVE EVIDENCE OF IMPAIRMENT

The United Nations carries an impairment review of its financial assets at each Statement of Financial Position date. The aim of this review is to determine whether there is objective evidence that impairment exists for a financial asset. The United Nations recognizes an impairment loss only if there is objective evidence of impairment as a result of past event that occurred after initial recognition.

Determining whether there is impairment requires judgment and consideration of all the relevant facts and circumstances.

The majority of the financial assets held by the United Nations are comprised of Assessed contributions receivable, Voluntary contributions receivable and investments in debt securities (such as time deposits) classified as loans and receivables. The United Nations evaluates the following observable data points for impairment in order of priority:

- Significant financial difficulty of the obligor;
- A breach of contract, such as a default or delinquency in interest or principal payments;

- For economic or legal reasons relating to the obligor's financial difficulty, granting to the obligor a concession that the United Nations would not otherwise consider;
- It becomes probable that the obligor will enter bankruptcy or other financial reorganization (e.g. non-governmental related receivables);
- Observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:
    - adverse changes in the payment status of borrowers in the group (for example, an increased number of delayed payments); or
    - national or local economic conditions that correlate with defaults on the assets in the group (for example, an increase in the unemployment rate in the geographical area of the borrowers, , or a decrease in oil prices for loan assets to oil producers).

Note: A downgrade of a borrower's credit rating is not, of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information.

A decline in the fair value of a financial asset below its cost or amortized cost is not necessarily evidence of impairment (for example, a decline in the fair value of an investment in a debt instrument that results from an increase in the risk-free interest rate).

3.6.2 STEP 2: MEASUREMENT AND RECORDING OF IMPAIRMENT

If there is objective evidence of impairment, the United Nations will measure and record the impairment loss in the reporting period.

The amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows.

The expected future cash flows that are included in the calculation are the contractual cash of the instrument itself, reduced or delayed based on the current expectations of the amount and timing of these cash flows as a result of losses incurred at the Statement of Financial Position date. In circumstances where the amount outstanding is expected to be collected in full, but the collection period is delayed, an impairment loss must still be recognized, unless the United Nations receives full compensation (for example, in the form of penalty interest) for the period of the delinquency.

In some circumstances, it may not be practicable to make a reasonably reliable direct estimate of the present value of future cash flows, hence as a practical alternative, the carrying amount of the impaired asset may be determined in these circumstances on the basis of an instrument's fair value using an observable market price. A loan's observable market price is the loan's quoted price that can be obtained from reliable market sources. For example, loans with an active secondary market could be measured based on the observable

market price. However, it is likely that the use of the observable market price will be infrequent, because either there may not be a market for the loans or the market may be illiquid.

Where an impaired financial asset is secured by collateral, the calculation of the present value of the estimated future cash flows of the collateralized financial asset should reflect the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable. As the measurement of the impaired financial asset reflects the collateral asset's fair value, the collateral is not recognized as an asset separately from the impaired financial asset, unless it meets the recognition criteria for an asset in another standard.

According to IPSAS 29, the carrying amount of the asset can be reduced either directly by writing it down or through use of an allowance account such as a loan loss provision or provision for bad and doubtful debts (e.g. the allowance for doubtful receivables). The United Nations has elected to use an allowance account for recording impairment of financial assets. Carrying value will be stated net of related allowances in the Statement of Financial Position of the United Nations.

3.6.3 IMPAIRMENT ASSESSMENT FOR VOLUNTARY AND ASSESSED CONTRIBUTION RECEIVABLES

The impairment assessment process of the United Nations for voluntary and assessed contribution receivables follows the guidance for the impairment assessment of a group of financial assets as follows:

- Voluntary and assessed contribution receivables that are considered to be **individually significant**[2] are assessed for impairment individually based on whether objective evidence of impairment exists;
- All other contribution receivables that are not individually significant are assessed for impairment **either individually or collectively** on a group basis as indicated below;
- All contribution receivables that have been individually assessed for impairment, whether significant or not, but for which there is no objective evidence of impairment, are included within a group of receivables with similar credit risk characteristics and **collectively assessed** for impairment;
- Contribution receivables that are individually assessed for impairment and for which an impairment loss is (or continues to be) recognized are **not** included in the **collective assessment** for impairment.

Example – Individual versus collective assessment

An entity has a portfolio of similar receivables amounting to $100m. The entity considers that within this portfolio are $30m of receivables that are individually significant. It assesses these receivables for impairment on an individual basis and determines that $20m of receivables are impaired. Of the remaining $70m that are not individually significant, the entity selects $15m for individual assessment and finds them all to be individually impaired. The rest of the portfolio is subject to an impairment review on a collective basis.

[2] Refer to Corporate Guidance paper on Materiality for further guidance on how to determine individually significant receivables.

The result of this assessment means that receivables amounting to $35m that have been assessed for impairment on an individual basis, whether significant or not, and found to be impaired will not be included for collective assessment. The remaining $65m of receivables ($10m of individually significant receivables that are found not to be impaired) and $55m that were not assessed for impairment on an individual basis) are included in the collective assessment.

However, loss probabilities and other loss statistics differ at a portfolio level between the $10m of individually evaluated receivables that are found not to be impaired and the $55m of receivables that were not individually evaluated for impairment. This means that a different amount of impairment may be required for these sub-portfolios.

For the purpose of a collective evaluation of impairment, contribution receivables are grouped on the basis of similar credit risk characteristics that are indicative of the debtors' ability to pay all amounts due according to the contractual terms. This may be done on the basis of a credit risk evaluation or grading process that considers contribution type, industry, geographical location, collateral type, past-due status and other relevant factors. If contribution receivables with similar risk characteristics cannot be grouped together, such receivables are individually assessed for impairment.

Applying the above process ensures that the collective assessment of impairment for a group of contribution receivables performed by the United Nations is still an ‘incurred’ and not an ‘expected’ loss model that aims to reflect the loss events that have occurred with respect to individual contribution receivables in the group, but have not yet been identified on an individual asset basis.

3.6.4 CHANGES IN ESTIMATED CASH FLOWS

The cash flows that are discounted to arrive at the effective interest rate are estimated cash flows that are expected to occur over the instrument's expected life. According to IPSAS 29, the United Nations will have to adjust the carrying amount of the financial asset or financial liability (or group of financial instruments) to reflect actual and revised estimated cash flows whenever it revises its cash flow estimates.

Example - Renegotiated payment terms for voluntary contribution receivable

The United Nations has a past due voluntary contribution receivable from XYZ. Subsequently it was agreed that XYZ will make payment in three annual installments. Based on the facts and circumstances, the United Nations believes that XYZ will make the payment as per the new agreed upon payment schedule.

Analysis:

The United Nations believes that the amount due from XYZ will be received; accordingly it does not trigger impairment of receivable. Further, the receivable balance from XYZ will not be considered past due as there is a new agreed upon payment schedule.

Since there is a change in payment pattern and the amount is expected to be received over three annual installments, the carrying amount of the financial asset should be adjusted to reflect the time value of money. The carrying amount should be recalculated by computing the present value of estimated future cash flows. The adjustment should be recognized in Statement of Financial Performance as expense.

Refer to case study in section 8.1 for example on renegotiated payment terms.

3.6.5 UNITED NATIONS POLICY FOR IMPAIRMENT OF CONTRIBUTION RECEIVABLE

Based on historical assessment, recognition patterns and no anticipated changes to the collection pattern the United Nations approach for impairment of receivable as explained in the policy framework is as follows:

Non-exchange receivables will be classified between assessed contributions and voluntary contributions receivable.

- Assessed contributions receivable:
    - Assessed contributions receivable from Member States:
        - Receivables from Member States that are subject to the Charter of the United Nations Article 19 General Assembly voting rights restriction due to arrears equalling or exceeding the amount of the contributions due from it for the preceding two full years and that are past due in excess of two years: 100 per cent allowance;
        - Receivables that are past due in excess of two years for which the General Assembly has granted special treatment as regards payment: United Nations Emergency Force (UNEF), United Nations Operation in the Congo (ONUC), unpaid assessed contributions by People's Republic of China which were transferred to a special account pursuant to General Assembly resolution 36/116 A, former Yugoslavia: 100 per cent allowance;
        - Receivables that are past due in excess of two years for which Member States have specifically contested the balance: 100 per cent allowance; (the two year time period is to allow for potentially resolving the contested matter);
            - any contested amount outstanding for less than two years will be disclosed in the Notes to the Financial Statements;
        - Assessed contributions receivable that are past due in excess of two years related to peacekeeping missions that have been closed over two years: 100 per cent allowance; and
        - For receivables with approved payment plans, no allowance will be established, rather disclosure will be made where necessary.
    - Assessed contribution receivable from Nonmember States: similar to Member States described above
- Voluntary Contributions receivables, trade receivables and other receivables:

- Specific identification – Provisioning will first go through specific identification of accounts receivable.
- Aging: The policy guidance is 25% allowance for receivables outstanding longer than 12 months, 60% for receivables outstanding longer than 24 months and 100% for receivables outstanding longer than 36 months.

Decisions for write-offs are considered at management level, or in the case of assessed or voluntary contributions from Member States – at the General Assembly level or Executive Body level, as appropriate. Accordingly a receivable balance should not be written-off unless appropriate approvals are in place.

This guidance does not address write-off approval process.

Refer to case study in section 8.1 for detailed explanation for hypothetical process of measuring and recording impairment of contribution receivables.

3.7 Derecognition of financial instruments

Derecognition is the term used for ceasing to recognize a financial asset or financial liability on the Statement of Financial Position.

The United Nations will derecognize a financial asset when and only when:

a) The contractual rights to the cash flows from the financial asset expire or are waived; or
b) It transfers the financial asset; either by: transferring the contractual rights to receive the cash flows of the financial asset; or retaining the contractual rights to receive the cash flow of the financial asset, but assuming a contractual obligation to pay the cash flows to one or more recipients in an arrangement that meets certain conditions.

Additionally, the United Nations will evaluate the extent to which it retains the risks and rewards of ownership of the financial asset. When the United Nations transfers a financial asset but neither transfers nor retains substantially all the risks and rewards of ownership, the United Nations will **determine whether it has retained control** of the financial asset to determine whether to continue recognizing it or to derecognize the asset.

The United Nations will derecognize a financial liability from its Statement of Financial Position when, and only when, it is **extinguished** (i.e. when the obligation specified in the contract is discharged, cancelled or expires). An exchange between an existing borrower and lender with substantially different terms will be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. Similarly, a substantial modification of the terms of an existing financial liability or a part of it will be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

3.7.1 SECURITIES LENDING AND REPURCHASE AGREEMENT ARRANGEMENTS

The United Nations may enter into securities lending transactions. In a typical securities lending agreement, the transferor / lender transfers a security to the transferee / borrower for a short period of time. The borrower is generally required to provide 'collateral' to the lender, commonly cash but sometimes other securities or a standby letter of credit, with a value slightly higher than the value of the security borrowed. If the collateral is cash, the lender earns a return and if it is other than cash, the lender receives a fee. At a specified date, the borrower returns the security to the lender.

A repurchase agreement involves the legal sale of a financial asset and will require the transferor to repurchase the transferred asset at a particular price at a pre-determined date. Such price may be fixed at the outset or be the market price at the time of the repurchase. Depending on the pricing arrangement, the analysis would be as follows:

- If the financial asset is loaned or sold under an agreement to repurchase the asset at a fixed price or at a price that provides a lender's return on the sale price, the transferred asset is not derecognized. This is because the transferor retains substantially all the risks and rewards of ownership of the transferred asset.
- If the financial asset is loaned or sold under an agreement to repurchase the transferred asset at fair value at the date of repurchase, the transferred asset is derecognized. This is because the transferor has transferred substantially all the risk and rewards of ownership of the transferred asset.

Please refer to the following examples of securities lending and securities purchased under agreements to resell transactions. The examples assume that derecognition is not achieved in the securities lending transactions which reflects the position on most of the United Nations' securities lending transactions based on United Nation's assessment.

Example (1) – Securities lending arrangement

The United Nations enters into an agreement with bank F to lend a debt security for 15 days for a fee of $1. The security is traded in an active market. At the same time, E pays $102 as cash collateral to the United Nations.

Accounting:

On the date of security lending – Cash collateral received:

Dr	Bank	$102	
Cr	Cash collateral on securities lent (current liability)		$102

Interest income over 15 days lending period using effective interest rate method

Dr	Bank	$1	
Cr	Interest income		$1

On the date of refund - Cash collateral paid

Dr	Cash collateral on securities lent (current liability)	$102	
Cr	Bank		$102

Example (2) – Security lending - cash pledge as collateral

The United Nations (transferor) lends securities with a carrying amount of $10,000 to Company A (transferee and third party). Company A pledges $10,200 in cash as collateral to the United Nations. The United Nations agrees to repurchase the securities in 35 days. The United Nations' return from investing the collateral is $30, based on an annual rate of 3 percent for 35 days, and $20, based on an annual rate of 2 percent for 35 days. The fair value of the transferred securities remains constant. Company A (the borrower of securities) sells the securities upon receipt and later buys similar securities to return to the United Nations (the securities lender). The transaction qualifies for secured borrowing treatment.

The following journal entries display the accounting treatment for this arrangement on the United Nations' general ledger:

At inception of the transaction:

To record the receipt of cash in exchange for securities collateral

Dr	Cash	$10,200	
Cr	Payable under securities loan agreements		$10,200

To reclassify loaned security that the secured party has the right to sell or pledge

Dr	Securities pledged to Company A	$10,000	
Cr	Securities		$10,000

To record investment of cash collateral

Dr	Money market instrument	$10,200	
Cr	Cash		10,200

At conclusion of the transaction:

To record results of short term investment

Dr	Cash	$10,230	
Cr	Interest income		$30
Cr	Money market instrument		$10,200

To reclassify security no longer pledged

Dr	Securities	$10,000	
Cr	Securities pledged to Company A		$10,000

To record repayment of cash collateral plus interest

Dr	Payable under securities loan agreements	$10,200	
Dr	Interest expense	$20	
Cr	Cash		$10,220

Example (3) – Security lending - securities pledged as collateral and borrower sells the securities

Company A enters into a short position by selling Securities S to a third party. The United Nations (transferor) lends debt securities (Securities S) with a fair value of $15,000 to Company A (transferee and third party). Company A pledges treasury securities (Securities T) with a fair value of $17,000 as collateral to the United Nations. The United Nations and Company A receive no return on investment because no cash is transferred. However, Company A pays a fee of $15 to the United Nations, based on an annual rate of 1 percent for 35 days. The United Nations agrees to repurchase Securities S in 35 days. The fair value of Securities S remains constant throughout the life of the arrangement. Company A (the borrower of securities) sells Securities S upon receipt and later buys similar securities to return to the United Nations (the securities lender). The transaction qualifies for secured borrowing treatment.

The following journal entries display the accounting treatment for this arrangement on the United Nations' general ledger:

At inception of the transaction:

To record the receipt of Security T in lieu of cash collateral that the transferor can sell or repledge

Dr	Securities (T)	$17,000	
Cr	Payable under securities loan agreements		$17,000

To reclassify pledged/loaned Securities (S) that the Company A has the right to sell or repledge

Dr	Securities (S) pledged to Company A	$ 15,000	
Cr	Securities (S)		$15,000

At conclusion of the transaction:

To reclassify Security S no longer pledged

Dr	Securities (S)	$15,000	
Cr	Securities pledged to Company A		$15,000

To record repayment/redelivery of Security T to Company A

Dr	Payable under securities loan agreements	$17,000	
Cr	Securities (T)		$17,000

To record fee for lending Security S to Company A

Dr	Cash	$15	
Cr	Security lending fee		$15

Example (4) – Securities purchased under agreements to resell at a specified future date

The United Nations enters into an agreement with bank F to purchase a debt security for $100. The security is traded in an active market. At the same time, the United Nations agrees to sell the security after 15 days from F at predetermined price of $101.

Accounting:

On the date of purchase of securities – Cash collateral received:

Dr	Reverse repurchase agreement (current assets)	$100	
Cr	Bank		$100

Interest income over 15 days lending period using effective interest rate method

Dr	Reverse repurchase agreement (current assets)	$1	
Cr	Interest income		$1

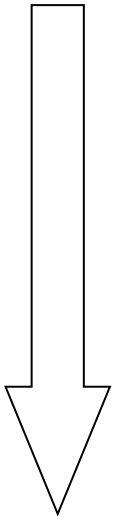
On the date of refund - Cash collateral paid

Dr	Bank	$101	
Cr	Reverse repurchase agreement (current assets)		$101

4 FAIR VALUE

Fair value is defined as "the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction". The price at which an asset could be exchanged is the price the United Nations would have **received** if it had **sold the asset**. Similarly, the price at which a liability is settled is the price the United Nations would have **paid** if it had been **relieved of the liability**. This implies that fair value is an estimate of the **market 'exit' price** that is determined by reference to a current hypothetical transaction between willing parties. Willing parties are presumed to be market-place participants representing unrelated buyers and sellers that are knowledgeable, having a common level of understanding about factors relevant to the asset or liability and the transaction and willing and able to transact in the same market(s) having the legal and financial ability to do so.

In looking for a reliable measure of fair value, the standard provides a hierarchy for determining an instrument's fair value as shown below:



- **Active Market – Quoted Market price:**

The hierarchy gives the highest priority to quoted prices in active markets. Refer to section 4.1 for a detailed explanation.

- **No Active market – Valuation technique**

For some of the financial assets for which fair values are required, there may be no active market. In the absence of an active market, fair value is established by using a valuation technique.

- **No active market equity investment – Cost less impairment**

Only as a last resort is an entity permitted to use cost and this is limited to unquoted equity instruments whose fair value cannot be measured reliably. The United Nations currently does not have any investment within this category.

Example of valuation method applied at the United Nations for certain investments

Investment	Valuation / pricing type
Bonds – United States Government Treasury notes	Trade/close, if available. Otherwise, bid
Bonds – United States Government Agency	Trade/close, if available. Otherwise, bid
Bonds – Non-United States Government	Trade/close, if available. Otherwise, bid
Bonds – Non-United States Government Agency	Trade/close, if available. Otherwise, bid
Bonds – Supranationals	Trade/close, if available. Otherwise, bid
Bonds – United States Corporate	Trade/close, if available. Otherwise, bid
Bonds – Non-United States Corporate	Trade/close, if available. Otherwise, bid

Investment	Valuation / pricing type
US Treasury Bill	Trade/close, if available. Otherwise, bid
Agency Discounted Notes	Trade/close, if available. Otherwise, bid
Commercial Paper (CP) Discounted	Trade/close, if available. Otherwise, bid
Certificate of Deposit (CD)	Trade/close, if available. Otherwise, bid
Euro CDs	Trade/close, if available. Otherwise, bid
Time Deposits	Valuation technique

4.1 Quoted prices in an active market

The existence of published price quotations in an active market is the best evidence of fair value and, where available, they must be used to measure the financial instrument. The phrase 'quoted in an active market' means that quoted prices are **readily and regularly available** from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis.

In determining whether a market is active, the emphasis is on the **level of activity** for a particular asset or liability. For instance, if the market is not well established and only a small volume of a particular instrument is traded relative to the amount of the instrument in issue or trading is infrequent, quoted prices in those markets will not be suitable for determining fair value. In that situation, the United Nations will have to move down the hierarchy to determine a suitable fair value.

4.1.1 BID-ASK SPREAD

In an active dealer market where bid and ask prices are more readily and regularly available than closing prices, fair value will be determined using these prices. However, the price that will normally be appropriate for valuation purposes will depend on whether the relevant financial instrument being valued is an asset or a liability, and whether it is already held or to be acquired. IPSAS 29 specifies the appropriate quoted market prices that should be used as indicated in the table below.

	Instrument held	Instrument to be acquired
Financial asset	Bid	Ask
Financial liability	Ask	Bid

The bid price represents the price a dealer is willing to pay for the instrument and, therefore, the price the entity would receive if it sold the asset. The ask price represents the amount at which a dealer is willing to sell the instrument and, therefore, the price that the United Nations would have to pay to acquire the asset. IPSAS 29 does not permit the use of mid-market price (average of bid and ask prices) for valuation purposes when quoted bid and ask prices are available.

4.1.2 UNAVAILABILITY OF PUBLISHED PRICES AT REPORTING DATE

Where current prices of financial instruments are unavailable at the reporting date, the price of the most recent transaction will be used adjusted for any changes in conditions between the date of the transaction and the Statement of Financial Position date. This valuation technique is considered further below.

4.2 Valuation techniques in the absence of an active market

The best evidence of fair value is the quoted price in an active market. If the market for a financial instrument is not active, fair value will be determined using a valuation technique. The objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations.

As the objective of the valuation process is to arrive at a reasonable estimate of a financial instrument's fair value, the technique used by the United Nations should reasonably reflect how the market could be expected to price the instrument. That expectation is likely to be met if the valuation technique makes maximum use of market inputs and relies as little as possible on entity-specific inputs. Also the inputs should reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument. The valuation technique used by the United Nations will reflect how the market could be expected to price the instrument under the conditions that exist at the measurement date. Even where a market is considered to be inactive, the most recent transaction prices will be considered as an input to a valuation model, provided that these are not forced transactions.

4.2.1 RECENT TRANSACTION PRICES

Where current prices of financial instruments are unavailable at the reporting date, the United Nations will use the price of the most recent transaction. This simple technique provides a foundation for estimating fair value, as long as there has not been a significant change in economic circumstances since the relevant transaction occurred.

If, however, conditions have changed since the relevant transaction occurred, the fair value will reflect the change in conditions by reference to current prices or rates for similar financial instruments, as appropriate. An example would be a change in the risk-free interest rate following the most recent price quote for a corporate bond. That observable price would be adjusted to reflect the interest for the period between the transaction date and the measurement date (to take into account the time value of money), the effect on fair value of the changes in rates and any cash distribution in that period.

4.2.2 OTHER VALUATION TECHNIQUES

Where it is not possible to estimate a financial instrument's fair value by reference to market prices, the United Nations will use other valuation techniques (pricing models and methodologies). Because these require more estimation and assumptions, they are necessarily more subjective than the market price

approach. One valuation technique frequently used by the United Nations is the discounted cash flow (present value) approach.

4.2.2.1 Present value technique

Present value is a technique used to link future amounts (cash flows) to the present through a discount rate. Present value concepts are central to the development of techniques for estimating the fair value of financial instruments because the market exit price of a financial instrument represents market participant's collective estimate of the present value of its expected cash flows. Therefore, cash flows and discount rate should reflect only factors that are specific to the financial instrument being measured and should reflect assumptions that market participants would use in their estimates of fair value. Also, as the cash flows used are estimates rather than known amounts, a fair value estimate, using present value, is made under conditions of uncertainty. As market participants generally seek compensation for bearing the uncertainty inherent in cash flows (risk premium), the effect of variability (risk) in the cash flows should be reflected either in the cash flows or in the discount rate.

IPSAS 29 states that in applying discounted cash flow analysis, an entity uses discount rates equal to the prevailing rates of return for financial instruments having substantially the same terms and characteristics, including the credit quality of the instrument, the remaining term over which the contractual interest rate is fixed, the remaining term to the principal's re-payment and the currency in which payments are to be made.

Determination of discount rate for financial assets:

A wide variety of methods can be used to determine discount rates but in most cases these calculations resemble art more than science; still, it is important to be generally correct than precisely incorrect. With this objective the following method can be used to determine discount rate for financial assets where market rate is not readily available:

A. The time value of money based on the **risk-free rate** for monetary assets with maturity dates that coincide with the period covered by the cash flows and pose neither uncertainty in timing nor risk of default to the holder (rates should be consistent with the underlying economic factors of the currency in which the cash flows are denominated);
B. A **risk premium** due to uncertainty and illiquidity; and
C. Other factors that market participants would take into account in the circumstances.

The United Nations will measure receivables and payables with no stated interest rate at the original invoice amount if the effect of discounting is immaterial. Refer to Corporate Guidance paper on Materiality for further guidance on how to determine materiality. Further the current assessment which has been approved by the Board of Auditors is that the impact of discounting is expected to be immaterial for receivables and payables.

Note: Discount rate to be considered at the United Nations

The current assessment based on the discussion with the Board of Auditors is that for significant balances the discount rate will be based on the opportunity cost which is the rates of return that could have been earned from investments held in Cash Pools. The United Nations treasury will inform the annualized rate of return every six months in following matrix:

Annualized rate of return	**Main Pool**	**Euro Pool**
As at 31 December 2013		
Short term investment	[] %	[] %
Long term investment	[] %	[] %
As at 30 June 2014		
Short term investment	[] %	[] %
Long term investment	[] %	[] %

The method of calculating the discount rate will be reassessed periodically by UNHQ based on inputs from field office and other facts and circumstances.

4.3 Third party valuation

The United Nations may not have its own valuation model and may instead rely on broker quotes, third-party pricing services or information from other financial institutions. The existence of such prices does not necessarily indicate an active market. In this case, the United Nations needs to understand how the third party has derived that valuation and whether it is in accordance with the requirements of the IPSAS 29 requirement. Factors that the United Nations will consider include:

- Whether and how the valuation incorporates current market events (for example, does it include 'stale' prices);
- How frequently the valuation is updated to reflect changing market conditions;
- The number of sources from which the valuation is derived (a valuation derived from many quotes or data sources generally being preferable to one based on a small number);
- Whether it reflects actual transactions or merely indicative prices;
- Whether it reflects a price at which the United Nations could be expected to transact (for example, a market to which the United Nations has access); and
- Whether it is consistent with available market information, including any current market transactions in the same or similar assets.

5 OTHER TOPICS

5.1 Cash Pools

5.1.1 PRESENTATION OF CASH POOLS INVESTMENTS

Background:

The United Nations Secretariat is comprised of various entities and offices which operate their own budgets. In many cases each of them has temporarily unutilized funds. If each entity / office invested these funds individually they would incur higher administration costs and returns would be lower than if they were pooled into common funds. Therefore, excess cash is pooled together and United Nations Treasury invests the commingled cash from the participants into short and long term fixed income securities including bank deposits, short term money market instruments (CDs, CPs), and high grade bonds of 5 years or less. The United Nations currently operates two investment pools:

- Main pool – over 60 participants; and
- Euro pool – around 9 participants.

Each participant's cash is invested in a pool of securities managed by the Cash Pool funds. Since the funds are commingled and invested on a pool basis by the funds, each participant is exposed to the overall risk of the investments portfolio to the extent of the amount of cash invested.

Each participant receives a pro-rata share of gains or losses generated from the funds invested by the Cash Pools and participation in the pool implies sharing the returns on investments with the other participants.

The United Nations Treasury manages the Cash Pool funds independently in accordance with United Nations policies and procedures. The Cash Pool funds are not controlled nor managed by any of the participants.

Based on a separate assessment the United Nations has determined that the Cash Pool funds need not to be consolidated by any of the participants.

IPSAS Presentation and Disclosure:

Presentation in Statement of Financial Position of pool participants:

The investment in the Cash Pool funds by pool participants will be presented as separate lines of cash and cash equivalents in Cash Pools, short-term investments in Cash Pools and long-term investments in Cash Pools to mirror cash pool funds' presentation of investments in their Statement of Financial Position. The investment in the Cash Pool funds by pool participants will represent the amount invested in the funds at the end of the reporting period.

Presentation in Statement of Financial Performance of pool participants:

Net gain / loss allocated to the pool participants by the Cash Pool will be presented as separate line within investment revenue in Statement of Financial Performance (please refer to proposed IPSAS format of Statement of Financial Performance in UN IPSAS Policy framework).

Presentation in Statement of Cash Flows of pool participants:

Cash flows from investing in Cash Pools will be disclosed as part of cash flows from investing activities.

- Investments by pool participants will be presented as investment in Cash Pool during the year;
- Withdrawals by pool participants will be presented as withdrawals from the Cash Pool during the year;
- Net gain / loss allocated to the pool participants will be presented as non-cash adjustment during the period within operating activities; and
- Cash received for net gain / loss allocated to the pool participants will be presented as investment income received during the year.

Note: Cash Pool funds should account for its investments in accordance with the guidance in this document.

Risk Management disclosure in Notes to Financial Statements:

IPSAS 30 states that the risk management disclosures should primarily be based upon how the information is reported to the key management personnel of the United Nations and how the United Nations manages the risk arising on investment by the Cash Pools.

The following factors indicate how the management of Cash Pool funds is performed at the United Nations:

- Cash Pool funds are invested by the United Nations Treasury in a centralized fashion as prescribed by the United Nations policies and procedures;
- The sole objective of the Cash Pool funds is to invest and manage funds received from its participants;
- The funds received from the participants are commingled in the Cash Pools, each participant being exposed to the overall risk profile of the investments of the funds, in proportion to their participation;
- The investments are monitored by the United Nations Treasury and key management personnel at the United Nations on a centralized basis; and
- Pool Participants can demand cash from Cash Pools but do not have the rights to demand the underlying investments of the Cash Pool funds, rather their claim is fulfilled by the Cash Pools in the form of cash.

According to IPSAS 30, each participant will have to provide risk disclosure about their exposure to the risks of investing in the Cash Pools. The disclosures will be based on how each participant views and manages its risks that are, using the information provided to management by the Cash Pool funds. Given the integrated structure and that the Cash Pools' sole purpose is investment of the commingled participant funds, management views that the risk exposures of each participant are the same as those of the Cash Pool

funds. Each participant will provide full disclosure of the risks inherent in the portfolio of the Cash Pools in their stand-alone financial statements adopting a 'look through' approach.

5.1.2 DEBT SECURITY CLASSIFIED AS FAIR VALUE THROUGH SURPLUS OR DEFICIT

The following example explains the changes to accounting practice currently followed under UNSAS at the United Nations for a financial instruments classified at fair value through surplus and deficit under IPSAS regime.

Example – Debt security classified as Fair value through surplus and deficit

On 1 October 2013, the United Nations purchases a 10% $10 million 5 year bond with interest payable on 1 April and 1 October each year. The bond's purchase price is $10,811,100. The premium of $811,100 is due to market yield for similar bonds being 8%. There are no transaction costs. The effective interest rate is 8%.

The United Nations classifies the bond as fair value through surplus and deficit. The United Nations prepares its financial statements at 31 December. On 31 December 2013, the yield on bonds with similar maturity and credit risk is 7.75%.

On 31 December 2013, the fair value of this bond calculated by discounting 10 semi-annual interest cash flows of $500,000 and principal payment of $10 million at maturity at the market rate of 7.75% amounted to $11,127,710.

Analysis:

Accounting as per prior practice under UNSAS:

Premium calculation

Purchase cost	10,811,100
Accrued Interest on purchase date	-
Clean price	10,811,100
Less Face value	10,000,000
Premium	811,100

Premium amortization as per prior method under UNSAS:

Purchase date	1-Oct-13
Maturity date	30-Sep-18
Days	1825
Premium amortization per day	444

Interest accrual per day under UNSAS:

Interest based on coupon @ 10%	1,000,000
Interest per day	2,740
Accounting under UNSAS	**31-Dec-13**
Purchase cost	10,811,100
Premium amortization for 91 days	(40,444)
Net balance	10,770,656
Accrued interest for 91 days	249,315
Carrying value as at 31-Dec-13	11,019,971

Accounting analysis as per IPSAS:

Since the bond is classified as fair value through surplus and deficit, the bond will be measured at fair value with changes in fair value recognized in Statement of Financial Performance.

Purchase cost	10,811,100
Fair value as at 31-Dec-13	11,127,710
Gain to be recorded in Statement of Financial Performance	316,610

Adjustment from prior UNSAS accounting practice to IPSAS:

Carrying value as per prior UNSAS practice	11,019,971
Carrying value as per IPSAS	11,127,710
Adjustment entry	107,739

Reconciliation from prior UNSAS practice to IPSAS:

Interest income recognized in Statement of Financial Performance:	249,315
Amortization	(40,444)
Income recorded in Statement of Financial Performance	208,871
Fair value gain recognized under IPSAS	316,610
Difference as compared to prior practice	107,739

Policy choice for disclosure under IPSAS:

Where these financial instruments accrue interest income or expense, the standard allows an accounting policy choice on how to disclose these. Interest income and interest expense on debt securities income can be reported as part of net gains or net losses on these financial instruments or can be disclosed separately as part of interest income and expenses.

However, if the United Nations chooses to present interest income separately then it should be calculated based on effective interest rate method as explained below.

On 31 December 2013, interest income for the 3 months at the effective interest rate of 8%, that is, $10,811,100 × 8% × 3/12 = $216,222. Since the next coupon of $500,000 is due on 1 April 2014, the United Nations will record a half-year interest accrual of $250,000. The difference of $33,778 between the interest income accrued and that recognized in the Statement of Financial Performance represents the amortization of the premium.

5.2 Loans issued at lower than market rate

Background:

The United Nations Habitat and Human Settlements Foundation (“UN Habitat" or the "lender”), enter into an agreement with ABC Housing Association (“ABC" or the "borrower”) on 1 December 2012, where by the lender agreed to lend money to borrower to support the borrower’s overall purpose of promotion of affordable and socially sustainable housing for the people of XYZ City. Overall limit under this agreement is $100,000,000.

Per the terms of the agreement UN Habitat advance $200,000 to ABC on 1 January 2013 i.e. beginning of the financial year, with the following terms and conditions:

Capital is repaid as follows:

- Year 1 to 3: no capital repayments
- End of year 4: 20% capital to be repaid
- End of year 5: 80% capital to be repaid

Interest is calculated at 5% interest on the outstanding loan balance, and is paid annually in arrears.

Assumed market rate of interest for a similar loan on 1 January 2013 was 10%.

Analysis:

The lender has provided the loan to the borrower for promotion of sustainable housing at an interest rate below market rate of interest.

This transaction is type of non-exchange transaction where the UN Habitat has received no direct consideration in return for the loan provided.

In this case, UN Habitat should recognize the loan at its initial fair value and quantify the difference between the initial carrying value and the proceeds. This difference will be immediately expensed.

Computation of present value of loan based on contractual terms:

End of the year	Contractual cash flow at the end of each year		Present value of contractual payments at market rate	
1	10,000	=200,000*5%	9,091	=10000/(1+10%)^1
2	10,000	=200,000*5%	8,264	=10000/(1+10%)^2
3	10,000	=200,000*5%	7,513	=10000/(1+10%)^3
4	50,000	=(200,000*5%) + (200,000*20%)	34,151	=50000/(1+10%)^4
5	170,000	=(200,000*5%) + (200,000*80%)	105,557	=170000/(1+10%)^5
		Present value	**164,576**	

Computation of off-market component:

Loan amount	200,000
Present value at market rate i.e. fair value of loan	164,576
Off-market portion	**35,424**

Loan will be accounted at amortized cost per the following schedule:

Year	1	2	3	4	5
Loan - Opening balance (amortized cost)	164,576	171,034	178,137	185,951	154,546
Market rate of interest	16,458*	17,103*	17,814*	18,595*	15,454*
Cash received	(10,000)	(10,000)	(10,000)	(50,000)	(170,000)
Loan - Closing balance (amortized cost)	171,034	178,137	185,951	154,546	-

* 10% of opening outstanding loan balance at amortized cost

Accounting entries for year 1:

On initial recognition			
Dr	Loan	164,576	
Dr	Expense	35,424	
Cr	Bank		200,000
End of year 1 - Interest accrual using the effective interest method			
Dr	Loan	16,458	
Cr	Interest revenue		16,458
End of year 1 - Interest payment for the first year			
Dr	Bank	10,000	
Cr	Loan		10,000

5.3 Promissory Notes received from parties to the Multilateral Fund (UNEP)

Background:

In November 1993, the Executive Committee of the Multilateral Fund (MFL) decided that promissory notes constitute committable resources and that the deposit of a promissory note by a party would be considered as payment of a party's assessed contribution.

Currently, about 4 Member States use promissory notes to make their contributions. The promissory notes are kept at the Central Bank of the Member State. The promissory note normally has a schedule of payment spread across the year as the funds would be needed by the United Nations over the year. The Central Bank advises the United Nations on receipt of the promissory note on behalf of the United Nations.

Promissory note is non-negotiable, non-interest bearing and irrevocable instrument. The promissory notes are cashed in either on a fixed schedule or with the option of accelerated encashment on demand by the United Nations on an as needed-basis, on a pro-rate basis or on demand.

Analysis:

Assessed contribution is recognized as revenue with a corresponding receivable at the beginning of the year as per the accounting guidance in Corporate Guidance paper #5 on accounting for non-exchange transaction.

Essentially, the United Nations has received a promissory note in lieu of assessed contribution receivable.

Assessment of facts is summarized as follows:

- Promissory note received from the Central Bank of the Member State acts as an added confirmation to the United Nations that the funds will be made available to the United Nations.
- Promissory note has a pre-determined schedule spread across the year; however they have an option of accelerated encashment on demand by the United Nations in light of needs on a pro-rated basis or on demand.
- Promissory note does not alter any contractual right to receive funds that could have adverse impact on the United Nations; rather this is more like a payment mechanism from certain Member States.

Accounting:

When a promissory note is received from a Member State as the mode of payment of the Member State's assessed contribution, a promissory note asset account is debited and the contributing Member State's assessed contributions receivable account is credited. Promissory notes can be separately disclosed within the notes to the financial statements where contributions receivable balances are explained however it should be grouped as part of Assessed Contributions Receivable line item on the Statement of Financial Position.

5.4 Carbon credit

Background:

The United Nations Environment Programme (UNEP) announced it was becoming climate neutral in 2008 and established a Climate Neutral Network to promote the idea in February 2008. To achieve its objective of being climate neutral it must offset unavoidable emissions, e.g. office energy use. UNEP therefore buys Certified Emission Reduction (CER) from registered Clean Development Mechanism (CDM) projects.

To operationalize the objective of becoming climate neutral, a certain percentage of cost calculated based on CO2 emitted on specified activities like business travel, refrigerant use, official vehicle use, office energy use and energy consumption is transferred to the UNEP Climate Neutral Fund (CNL). The funds at CNL will be used for purchasing CERs.

The CERs are purchased from the open market just like any other commodity, but United Nations Agencies have to buy CERs approved by UNFCCC.

Example:

During the year 2013 UNEP

- Emitted 12,000 tons of CO2
- Purchased and retired 10,000 tons of CO2 by paying $300,000

As at 31 December 2013, the market price to purchase one CO2 is $33.

During the year 2014 UNEP

- Emitted 15,000 tons of CO2
- Purchased and retired 16,000 tons of CO2 by paying $544,000

As at 31 December 2013, the market price to purchase one CO2 is $35

Analysis:

Although the UNEP does not have a legal liability towards CO2 emission, UNEP has:

1. Publicly announced policy for being carbon neutral;
2. Past practice of purchasing CER and retiring those; and
3. There is a valid expectation that UNEP will remain carbon neutral.

United Nations has created a constructive obligation by buying CERs and remaining climate neutral. Accordingly provision for liability to discharge outstanding CO2 should be recognized at the end of each reporting period.

Assets are resources controlled by the United Nations as a result of past events and from which future economic benefits or service potential are expected to flow to the United Nations. The United Nations does not expect any further cash flows on purchase of CERs as CERs are retired at the time of purchase; accordingly the purchase cost of CERs should not be capitalized.

Accounting entries:

For year 2013
On purchase and retirement of 10,000 CO2:

Dr	Expense	$300,000	
Cr	Bank		$ 300,000

Record provision for outstanding CO2: (12,000-10,000)*33

Dr	Expense	$66,000	
Cr	Liability		$66,000

For year 2014
Reversal of opening provision:

Dr	Liability	$66,000	
Cr	Expense		$66,000

On purchase and retirement of 16,000 CO2:

Dr	Expense	$544,000	
Cr	Bank		$ 544,000

Record provision for outstanding CO2: (2,000+15,000-16,000)*35

Dr	Expense	$35,000	
Cr	Liability		$35,000

6 PRESENTATION OF FINANCIAL INSTRUMENTS

6.1 Current or non-current

The United Nations should present current and non-current assets, and current and non-current liabilities, as separate classifications on the face of the Statement of Financial Position.

6.1.1 CURRENT AND NON-CURRENT ASSETS

An asset should be classified as current when:

- The United Nations expects to realize the asset, or intends to sell or consume it in its normal operating cycle i.e. 12 months for the purpose of IPSAS financial statements;
- The United Nations holds the asset primarily for the purpose of trading;
- The United Nations expects to realize the asset within 12 months after the reporting period; or
- The asset is cash or a cash equivalent, unless it is restricted from being exchanged or used to settle a liability for at least 12 months after the reporting period.

If an asset is not classified as current it should be classified as non-current.

6.1.2 CURRENT AND NON-CURRENT LIABILITIES

A liability should be classified as current when:

- The United Nations expects to settle the liability in its normal operating cycle i.e. 12 months for the purpose of IPSAS financial statements;
- the liability is due to be settled within twelve months after the reporting period;
- The United Nations holds the liability primarily for the purpose of trading; or
- The United Nations does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period.

If a liability is not classified as current it should be classified as non-current.

6.2 Netting off

A financial asset and a financial liability should be offset when, and only when, both of the following conditions are satisfied:

- The United Nations currently has a legally enforceable right to set off the recognized amounts.
- The United Nations intends either to settle on a net basis, or to realize the asset and settle the liability simultaneously.

Where the above offset conditions are satisfied the United Nations has in effect only a single financial asset or financial liability. In that situation, the financial asset and the financial liability are presented on the Statement of Financial Position on a net basis.

Example: Troop contributing country

The United Nations has assessed contribution receivable of $10 million from country ABC. Additionally the United Nations has a payable of $1 million towards troop contributed by country ABC.

Analysis:

Since the United Nations do not intend to settle both receivable and payable net, $10 million should be presented as receivable and $1 million should be presented as payable.

6.3 Cash and cash equivalents

Cash and cash equivalents are defined as follows:

- Cash comprises cash on hand and demand deposits.
- Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Cash equivalents are held by the United Nations for the purpose of meeting short-term cash commitments rather than for investment or other purposes. For an investment to qualify as a cash equivalent it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of three months or less from the date of acquisition.

To the extent that investments meet the definition of cash equivalents, they should be included in the heading 'cash and cash equivalents'. To the extent that they do not, they should be shown as ‘investments’.

7 DISCLOSURES REQUIREMENTS

7.1 Scope

Disclosure requirements are governed by IPSAS 30: *Financial Instruments: Disclosures.* The Standard applies to all types of financial instruments, except those that are specifically covered by another standard such as interests in subsidiaries, associates and joint ventures, employers' rights and obligations arising from employee benefit plans and insurance contracts. For disclosure purpose as per IPSAS 30 finance leases are within the scope whereas operating leases are excluded as they are not regarded as financial instruments.

The United Nations will provide disclosures in its financial statements that enable evaluation of:

- The significance of financial instruments (figures in the Statement of Financial Position and Statement of Financial Performance); and
- The nature and extent of risks arising from financial instruments to which the United Nations is exposed (quantitative disclosure) and how the United Nations manages those risks (qualitative disclosures).

This section provides general overview of the disclosure requirements with a focus on key disclosure applicable to the United Nations.

IPSAS 30 has numerous disclosure requirements. The compilation of the disclosures requires pre-planning including certain system-generated reports and inputs from various divisions. The disclosure requirements are applicable to all the financial statements compiled by the United Nations Secretariat i.e Volume I, Volume II, UNHABITAT, UNEP, UNODC, ITC, UNCC, UNITAR, UNCC, ICTR, ITY, Mechanism for International Criminal Tribunals, the ESCROW Account and UNU.

As discussed earlier in section 5.1 the following has been agreed with the Board of Auditors:

- The investment in the Cash Pool funds by pool participants will be presented as separate lines of cash and cash equivalents, short-term and long-term investments to mirror cash pool funds' presentation of investments in their Statement of Financial Position.
- Pool participant will provide full disclosure of the risks inherent in the portfolio of the Cash Pools in their stand-alone financial statements adopting a 'look through' approach.

Note: To implement IPSAS disclosure requirements, each Cash Pool will provide:

- Cash Pool's financial information along with share of each pool participant; and
- Risk management disclosures for the entire portfolio.

Each Cash Pool should prepare financial information by applying accounting and disclosure requirements in this Corporate Guidance paper. Additionally refer to section 7.8 for information to be included in Cash Pools financial information.

7.2 Statement of Financial Position

The carrying amounts of each of the following categories shall be disclosed either **in the Statement of Financial Position or in the notes**:

1) Financial assets at fair value through surplus or deficit, showing separately
   a) those designated as such upon initial recognition, and
   b) those classified as held-for-trading
2) Held-to-maturity investments;
3) Loans and receivables;
4) Available-for-sale financial assets;
5) Financial liabilities at fair value through surplus or deficit, showing separately
   a) those designated as such upon initial recognition, and
   b) those classified as held-for-trading; and
6) Financial liabilities measured at amortized cost.

Example – Presentation of categories of financial instruments

The United Nation has decided to disclose category of financial instruments in notes to the financial statements.

Extract of the line items which represent financial instruments or can include financial instruments from Statement of Financial Position from the United Nations IPSAS Policy:

United Nations Volume II - Statement of Financial Position (Financial Instruments only) As at 31 December 20X1 (Thousands of United States dollars)			
	Notes	**31-Dec 20X1**	**31-Dec 20X0**
ASSETS			
Current Assets			
Cash and cash equivalents*			
Investments*			
Assessed contributions receivable			
Voluntary contributions receivable			
Other receivables			
Other assets			
Non-current assets			
Investments*			
Other receivables			
Other assets			
LIABILITIES			

United Nations Volume II - Statement of Financial Position (Financial Instruments only) As at 31 December 20X1 (Thousands of United States dollars)			
Current Liabilities			
Accounts payable – Member States			
Accounts payable – other			
Transfers payable			
Other liabilities			
Non-current Liabilities			
Transfers payable			
Other liabilities			

* Predominantly investments in Cash Pool funds. The investment in the Cash Pool funds by pool participants will be presented as separate lines of cash and cash equivalents, short-term and long-term investments to mirror Cash Pool Funds presentation of investments in their Statement of Financial Position.

Example for presentation of financial instruments by category (where a reporting entity has all categories of financial instruments) in notes to financial statements:

Financial assets as per statement of financial position	Loans and receivables	Assets at fair value through surplus and deficit	Available for sale	Held to maturity	Derivatives	Total
Cash and cash equivalents						
Investments						
Contribution receivable						
Other accounts receivable						
Loans receivable						
Other assets						
Total						

Financial liabilities as per statement of financial position	Other financial liabilities at amortized cost	Liabilities at fair value through surplus and deficit	Derivatives	Total
Accounts payable				
Transfers payable				
Borrowings				
Other liabilities				
Total				

Example: Investments by UNSMIS

Background:

Volume I includes a fund created to reimburse serving and retired staff members for the costs of medical care in the event of sickness, accident or childbirth. It is referred to as United Nations Staff Mutual Insurance Society (UNSMIS). The United Nations has certain investments in bonds, treasury bills and commercial papers earmarked for UNSMIS claims. Those earmarked investments are indented to be used for aforesaid claims however there is no legal or contractual restriction on sale of those investments.

Analysis:

Accounting for claims should be based on UN IPSAS Corporate Guidance paper # 8 Employee benefits.

Accounting assessment for the investments should be as per the guidance in this paper. Additionally since these investments are not restricted they are not required to be separately disclosed on the face of Statement of Financial Position. However if material the notes to financial statements should provide a brief description of the fund, the mechanism of managing the fund and the financial risk management and fair value disclosures required by IPSAS 30.

When financial assets are impaired by credit losses and the impairment in a separate account (for example, an allowance account used to record individual impairments or a similar account used to record a collective impairment of assets), it should disclose a reconciliation of changes in that account during the period for each class of financial assets.

7.3 Statement of Financial Performance

The United Nations should disclose the following items of revenue, expense, gains, or losses either in the **Statement of Financial Performance or in the notes**:

1) Net gains or net losses on:
   a) Financial assets or financial liabilities at fair value through surplus or deficit, showing separately those on financial assets or financial liabilities designated as such upon initial recognition, and those on financial assets or financial liabilities that are classified as held for trading
   b) Available-for-sale financial assets, showing separately the amount of gain or loss recognized in net assets during the period and the amount reclassified from net assets and recognized directly in surplus or deficit for the period;
   c) Held-to-maturity investments;
   d) Loans and receivables; and
   e) Financial liabilities measured at amortized cost;
2) Total interest revenue and total interest expense (calculated using the effective interest method) for financial assets or financial liabilities that are not at fair value through surplus or deficit;

3) Fee revenue and expense (other than amounts included in determining the effective interest rate) arising from:
   a) Financial assets or financial liabilities that are not at fair value through surplus or deficit; and
   b) 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;
4) Interest revenue on impaired financial assets;
5) The amount of any impairment loss for each class of financial asset. (Excludes financial assets at fair value through surplus or deficit as they are carried at fair value, refer section 3.6 for additional guidance).

Example – Presentation of revenue, expense, gains, or losses from financial instruments in notes to financial statements

Gains or losses from financial instruments	2014	2013
Loans and receivables		
Financial assets measured at amortized cost		
Gains from investment in Cash Pools		
Financial assets or financial liabilities at fair value through surplus and deficit*:		
Designated on initial recognition		
Derivatives		

Interest income from financial assets or financial liabilities through surplus or deficit is included in net gains or losses.

Total interest income and total interest expenses

In 2014, the total interest income amounts to $[ ] million (in 2013: $ [ ] million) for financial assets which are not measured at fair value through surplus of deficit. Amounts are calculated by using the effective interest method.

Impairment losses

The following impairment losses on financial assets are recognized in Statement of Financial Performance in 2014 and 2013 respectively:

	2014	2013
Available-for-sale financial assets		
Loans and receivables		
Other[(1)]		
Total		

[(1)] Includes finance lease receivables.

*Except for financial information of cash pools and financial statements of certain entities financial instruments are not expected to be classified as financial assets or financial liabilities at fair value through surplus or deficit as they may not have investments in derivatives or investments managed on a fair value basis.

7.4 Accounting Policies

The summary of significant accounting policies, the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements should be disclosed.

To comply with this disclosure requirement the United Nations accounting policy will cover the following, if applicable:

- Composition of financial assets:
  - Classification of financial assets
  - Recognition and measurement
  - Impairment of financial assets
  - Derecognition of financial assets
  - Any specific situation i.e. offsetting of financial instruments, concessionary loan, transaction cost, interest recognition
- Cash and cash equivalents
- Contribution receivable
- Other receivable relating to exchange transactions
- Currency forward contract
- Composition of financial liabilities:
  - Recognition and measurement
  - Derecognition of financial liabilities
  - Payables

7.5 Fair value disclosure

For each class of financial assets and financial liabilities, the United Nations will disclose the fair value of that class of assets and liabilities in a way that permits it to be compared with its carrying amount.

The United Nations will 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.

7.5.1 FINANCIAL ASSETS AND LIABILITIES CARRIED AT FAIR VALUE

For fair value measurements **recognized in the Statement of Financial Position**, the United Nations will disclose for each class of financial instruments:

- The **level** in the fair value hierarchy into which the fair value measurements are categorized in their entirety.
- Any **significant transfers** between Level 1 and Level 2 of the fair value hierarchy and the reasons for those transfers. Transfers into each level shall be disclosed and discussed separately from transfers out of each level.
- For fair value measurements in **Level 3, a reconciliation** from the beginning balances to the ending balances, disclosing separately changes during the period.

The fair value hierarchy that reflects the significance of the inputs used in making the measurements will include the following levels:

- **Quoted prices** (unadjusted) in active markets for identical assets or liabilities (Level 1);
- **Inputs** other than quoted prices included within Level 1 that are **observable** for the asset or liability, either directly (i.e., as price) or indirectly (i.e., derived from prices) (Level 2); and
- Inputs for the asset or liability that are **not based on observable market data** (unobservable inputs) (Level 3).

Example – Presentation of fair valuation hierarchy for financial instruments measured at fair value

This sample disclosure represents a situation where the entity has investment in equity and debt securities in addition to investment in Cash pools. It is assumed that the United Nations does not have any instrument classified as level 3 for this example.

Financial instruments by category

Financial assets and liabilities measured at fair value	**Level 1**	**Level 2**	**Total**
Assets at fair value through surplus and deficit			
Investment in Cash pools			
Equity securities			
Debt securities			
Derivatives - Currency forward contracts			
Total assets			
Derivatives			
Derivatives embedded in lease contract			
Derivatives - Currency forward contracts			
Total Liabilities			

Example – Presentation of fair valuation hierarchy for financial instruments measured at fair value in Cash Pools financial information

It is assumed that the United Nations does not have any instrument classified as level 3 for this example.

Financial instruments by category			
Financial assets and liabilities measured at fair value	**Level 1**	**Level 2**	**Total**
Assets at fair value through surplus and deficit			
Bonds – Government agency			
Bonds – Non-United States			
Bonds –United States Treasury notes			
Discounted securities			
Equity securities			
Derivatives			
Currency forward contract			
Total assets			

Example – Presentation of fair valuation for financial instruments not measured at fair value

Financial assets and liabilities not measured at fair value	**Carrying value**	**Fair value**
Loans and receivables		
Term deposits		
Contribution receivable		
Other accounts receivable		
Loans receivable		
Other current assets		
Total		
Other financial liabilities at amortized cost		
Accounts payable		
Borrowings		
Other current liabilities		
Total		

Note: Instead of presenting by way of a table this disclosure can be included as a narrative paragraph if the fair value equals the carrying value. Example of narrative disclosure:

Voluntary contribution receivable - The fair values of current assessed contribution receivables are estimated to be equal to carrying value due to the short term nature of these financial instruments. The fair

values of long term assessed contribution receivables is $XYZ are determined on the basis of discounted expected future cash flows. The discounting is based on the current interest rates, at which similar loans with identical terms can be borrowed.

Cash and cash equivalents - Due to the short-term nature of these financial instruments, carrying value is a fair approximation for fair value.

Example – Classification of financial instruments

Instrument type	Example of investment	Pricing source	Method	Valuation / pricing type	Level*
Bonds – United States Government Treasury notes	U S TREASURY NT 0.375% 11/15/15	FT Interactive data	Institutional bond Quotes – Evaluation based on market and industry inputs	Trade/close, if available. Otherwise, bid	1 or 2
Bonds – United States Government Agency	F H L M C M T N 0.400% 2/27/14	FT Interactive data	Institutional bond Quotes – Evaluation based on market and industry inputs	Trade/close, if available. Otherwise, bid	1 or 2
Bonds - Supranational	ASIAN DEV BANK MTN 1.625% 7/15/13	FT Interactive data	Institutional bond Quotes – Evaluation based on market and industry inputs	Trade/close, if available. Otherwise, bid	1 or 2
Bonds –Non-United States Government	BELGIUM KINGDOM MTN 2.875% 9/15/14	FT Interactive data – Extel Financial Ltd	Evaluation based on market factors	Trade/close, if available. Otherwise, bid	1 or 2**
Bonds - Supranational	EUROPEAN INVT BK 1.625% 3/15/13	FT Interactive data – Extel Financial Ltd	Evaluation based on market factors	Trade/close, if available. Otherwise, bid	1 or 2**
Commercial paper – Discounted	PROVINCE OF QUEBEC C P 1/15/13	U.S .Bank pricing unit	Matrix pricing	Trade/close, if available. Otherwise, bid	1 or 2**
Currency forward contract	USD / CHF			Quotes received from the counterparties	2

* If the market is liquid the security will be classified as level 1

** If all the inputs are based on observable market data then level 2

7.6 Concessionary loans

For concessionary loans the United Nations shall disclose:

- A reconciliation between the opening and closing carrying amounts of the loans, including:
  - Nominal value of new loans granted during the period;
  - The fair value adjustment on initial recognition;
  - Loans repaid during the period;
  - Impairment losses recognized;
  - Any increase during the period in the discounted amount arising from the passage of time; and
  - Other changes;
- Nominal value of the loans at the end of the period;
- The purpose and terms of the various types of loans; and
- Valuation assumptions

7.7 Nature and extent of risks arising from financial instruments

The disclosures require focus on the risks that arise from financial instruments and how they have been managed by the United Nations. These risks typically include, but are not limited to, credit risk, liquidity risk, and market risk.

The standard does not prescribe a format for financial risk disclosures. However, to meet the requirements and to organise the necessary disclosures, each type of risk will be discussed differently. Credit risk needs to be discussed by class of financial instruments, whereas the maturity analysis required to explain liquidity risk exposures focuses on individual financial liabilities. Market risk exposures are explained by type of risk, if applicable, and illustrated using a sensitivity analysis. Alternatively (or additionally) an integrated sensitivity analysis may be presented to explain market risk exposures, if such an approach is used internally to manage financial risks.

The standard requires reporting of the metrics that are used internally to manage and measure financial risks, accordingly each reporting entity should assess the risk disclosure based on the guidance in this Corporate Guidance paper.

Example - Overview of disclosure requirements

The reporting entity's financial assets primarily include:

- Investments in Cash Pools,
- Investment in equity securities in addition to the investment in cash pools;
- Investment in time deposits in addition to the investment in cash pools; and
- Contributions receivable including significant receivables in currency other that USD.

Analysis of risk management disclosure requirements:

The reporting entities risk management disclosures should include:

- Nature and extent of risk and risk management framework at the entity; refer section 7.7.1
- Investment in Cash Pools; refer to guidance in section 5.1, 7.1 and 7.8
- Investment in equity securities, time deposits and contributions receivable in currency other than USD the entity should disclose price risk sensitivity, interest rate sensitivity and currency rate sensitivity, respectively; refer to guidance in section 7.7.2.3
- For liquidity risk: refer to guidance in section 7.7.2.2
- For credit risk: refer to guidance in section 7.7.2.1

Note: Each entity should make an objective assessment of the risk management disclosure based on the facts and circumstances.

Note: Investments in Cash pools.

- Cash pools financial information: Each Cash Pool should compile its disclosure for entire portfolio based on the disclosure requirements in this corporate guidance paper.
- Pool participant's financial statements: Pool participants should mention that the Pool participant bears the risk and reward in proportion to its investment in the Cash Pool.
- In some instances it is not possible to split the participant's share of the Cash Pool for disclosure purposes. For example, a fair value hierarchy is prepared for the total of each cash pool, however, since participants do not have a right to the underlying investments, e.g. bonds – US Treasuries (level 1), it is not valid to apply a participant's share percentage to calculate a participant's share of each item in the fair value hierarchy. In this case, a reporting entity would include the fair value hierarchy for the total cash pool to meet the IPSAS 30 requirement to present a fair value hierarchy.

This section provides certain hypothetical sample risk management disclosures.

7.7.1 QUALITATIVE DISCLOSURES

For each type of risk arising from financial instruments the United Nations will discloses:

- The exposures to risk and how they arise;
- Its objectives, policies, and processes for managing the risk and the methods used to measure the risk

  This might include, but is not limited to:

  - The structure and organization of the risk management functions, including a discussion of independence and accountability;
  - The scope and nature of the risk reporting or measurement systems;
  - Policies for hedging or mitigating risk, including its policies and procedures for taking collateral;

- The processes for monitoring the continuing effectiveness of such hedges or mitigating devices;
- The policies and procedures for avoiding excessive concentrations of risk;
- Any changes in the above for the period; and

- Any changes from the previous period.

Example - Sample disclosures for different types of risk

Nature and extent of risks arising from financial instruments

The Organization is exposed to a variety of financial risks: market risk, including foreign exchange risk, and interest rate risk; credit risk; and liquidity risk. Additionally the organizations share in the cash pool exposes it to financial risks of the Cash Pools. Please refer to Note [ ] for further discussion regarding risk arising from investments in Cash Pools.

Cash flow and cash flow forecasting

The Organization has largely stable annual cash flows from assessed contribution and donor agreement. Both short- and long-term cash flow forecasts are produced regularly to assist the treasury function in identifying short-term liquidity and long-term funding requirements. Based on budgets the funds are invested and withdrawn from Cash Pools. Cash flow forecasts are monitored regularly to assess liquidity adequacy for at least a 12 month period.

Market risk:

The Organization is exposed to market risk, primarily related to foreign currency exchange rates and interest rates. The Organization actively monitors and seeks to reduce, where it deems it appropriate to do so, fluctuations in these exposures.

Foreign currency exchange rate risk:
The Organization reporting currency is USD. As a result, the Organization is exposed to foreign currency exchange movements, primarily in European, Japanese and other Asian and Latin American currencies. The Organization uses forward contracts to hedge certain anticipated net expenses in foreign currencies.

Interest rate risk:
The Organization interest rate exposure arises primarily from time deposits. The Organization does not have significant interest rate risk other that its investment of excess cash in Cash Pools.

Commodity price risk:
The Organization has only a very limited exposure to price risk related to anticipated purchases of certain commodities used regularly as part of the Organizations operations. A change in those prices may alter the cash flows, but generally by not more than 5% of the budgeted cash flows. Accordingly, the Organization does not enter into commodity futures, forward and option contracts to manage fluctuations in prices of anticipated purchases.

Equity risk:
The Organization purchases equities as investments of its funds. Potential investments are thoroughly analyzed and tracked bt the management.

Credit risk:
Credit risks arise from the possibility that donors may not be able to settle their obligations as agreed. To manage this risk the Organization periodically assesses the financial reliability of donor, taking into account their financial position, past experience and other factors. No donor accounts for more than 5% of total receivables. There is no other significant concentration of credit risk.

Counterparty risk:
Counterparty risk encompasses issuer risk on marketable securities, settlement risk on derivative and money market contracts and credit risk on cash and time deposits. Issuer risk is reduced by only buying securities which are at least AA- rated. Settlement and credit risk is reduced by the policy of entering into transactions with counterparties that are usually at least AA- rated banks or financial institutions. Exposure to these risks is closely monitored and kept within predetermined parameters.

Liquidity risk:
Liquidity risk is defined as the risk that the Organization could not be able to settle or meet its obligations on time or at a reasonable price. Organization along with the United Nations Treasury is responsible for liquidity, and funding. In addition, liquidity and funding risks, related processes and policies are overseen by the United Nations management. The United Nations manages its liquidity risk on a overall basis based on cash flow needs and other operational and regulatory considerations.

7.7.2 QUANTITATIVE DISCLOSURES

For each type of risk arising from financial instruments, the United Nations will have to disclose:

- Summary **quantitative data about its exposure to that** risk at the end of the reporting period. This disclosure shall be based on the information provided internally to key management personnel of the United Nations, for example, the General Assembly;
- Details of **credit, liquidity and market risk** by class of financial instrument; and
- **Concentrations of risk**.

Disclosures based on information reported internally: As noted in the first bullet point, the United Nations will have to provide summary quantitative data about their risk exposures based on information reported internally to key management personnel. Judgment may be needed to establish the relevant key management personnel for each risk and the information they use that is relevant to each risk.

Minimum disclosures - credit, liquidity and market risk: IPSAS 30 sets out these minimum disclosures in relation to each type of risk. These disclosures are required regardless of whether management uses this information. However, the United Nations should not default to the minimum disclosures without going

through the initial 'management view' step. The minimum disclosures are required **if material** to the United Nations, for example, IPSAS 30 has mandatory currency risk disclosures; however, in some cases exposure to currency risk may not be material and therefore these disclosures are required.

7.7.2.1 Credit risk

The United Nations will disclose by class of financial instrument:

a. The amount that best represents its **maximum exposure to credit risk** at the end of the reporting period without taking account of any collateral held or other credit enhancements
b. In respect of the amount disclosed in (a), a **description of collateral** held as security and other credit enhancements;
c. Information about the **credit quality** of financial assets that are neither past due nor impaired; and
d. The **carrying amount** of financial assets that would otherwise be past due or impaired whose **terms have been renegotiated**.

Example – Description of credit risk

Credit risk

Credit risk refers to the risk that counterparty will default on its contractual obligations resulting in financial loss to the organization. Credit risk arises from cash balances (including bank deposits and cash and cash equivalents), investments and credit exposures for contribution receivable. Credit risk is managed separately for cash and cash equivalents, investments and contribution receivable credit exposures.

The organization aims to minimize its credit risk through the application of risk management policies approved and monitored by the board. Counterparties are limited to major banks and financial institutions and the policy restricts the exposure to any one counterparty by setting credit limits taking into account the credit quality of the counterparty. The organization's policy is designed to ensure that individual counterparty limits are adhered to and that there are no significant concentrations of credit risk. The board also defines the types of financial instruments which may be transacted. Financial instruments are primarily transacted with major international financial institutions with a long term credit rating within the A band or better.

The organization annually reviews the credit limits applied and regularly monitors the counterparties' credit quality reflecting market credit conditions.

Contribution receivables exposures are managed locally in the operating units where they arise. There is no concentration of credit risk with respect to voluntary contributions receivables as the organization has a large number of parties which are internationally dispersed.

Cash and cash equivalents comprise cash in hand and deposits which are readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value and have an original maturity of three months or less at acquisition including commercial paper and investments.

Note: Tabular disclosure for credit quality of investments including term deposits should be added.

For past due and impaired financial assets the United Nations should disclose by class of financial asset:

a. An analysis of the **age** of financial assets that are past due as at the end of the reporting period but not impaired;
b. An analysis of financial assets that are individually determined to be impaired as at the end of the reporting period, including the factors considered in determining that they are impaired; and
c. For the amounts disclosed in (a) and (b), a description of collateral held by the United Nations as security and other credit enhancements and, unless impracticable, an estimate of their fair value.

Example – Sample disclosure for Contribution receivable

Contribution receivable

Accounts receivable consist mainly of the currencies euro, US dollar and Japanese yen and are as follows:

Contributions receivable

	31-Dec-14	31-Dec-13
Contributions receivable, gross		
Less: accumulated allowances for doubtful accounts		
Less: accumulated allowances for changes in estimated cash flow		
Contributions receivable, net		

Movement in allowances for doubtful accounts

	31-Dec-14	31-Dec-13
Allowances at January 1		
Additions		
Reversals		
Write-offs charged against the allowance accounts		
Currency translation differences		
Allowances at December 31		

Accounts receivable past due but not impaired	past due 1 year	past due 2 years	past due 3 years	past due 4 years
31-Dec-14				
31-Dec-13				

With respect to contribution receivable past due but not impaired, based on credit history and current credit ratings, there are no indications that customers will not be able to meet their obligations. Further, no indications of default are recognizable for receivable that are neither past due nor impaired.

7.7.2.2 Liquidity risk

The United Nations will disclose:

- A **maturity analysis** for non-derivative **financial liabilities** (including issued financial guarantee contracts) that shows the remaining contractual maturities and derivative financial liabilities; and
- A description of how it manages the inherent liquidity risk.

In preparing the contractual maturity analyses, the United Nations uses judgment to determine appropriate time bands.

Example – Time band for liquidity risk disclosure

- Not later than one month.
- Later than one month and not later than three months.
- Later than three months and not later than one year.
- Later than one year and not later than five years.

For the maturity analyses based on **contractual cash flows**, when counterparty has a choice of when an amount is paid, the liability is included on the basis of the earliest date on which the United Nations can be required to pay. For example, financial liabilities that an entity can be required to repay on demand (e.g., demand deposits) are included in the earliest time band.

The amounts disclosed in the maturity analyses on a contractual basis are the contractual **undiscounted cash flows** (including principal and interest payments). The undiscounted cash flows described above differ from the amounts included in the Statement of Financial Position, which are based on discounted cash flows.

The United Nations will voluntarily disclose a **maturity analysis of financial assets** it holds for managing liquidity risk (e.g., financial assets that are readily saleable or expected to generate cash inflows to meet cash outflows on financial liabilities), if that information is necessary to enable users of its financial statements to evaluate the nature and extent of liquidity risk.

Example – Sample liquidity risk disclosure

Liquidity risk:

Liquidity risk is the risk arising from the Organization not being able to meet its obligations. The Organization manages its liquidity needs by monitoring scheduled short term and long term financial liabilities as well as forecast cash inflows and outflows due in day-to-day operations.

The data used for analyzing these cash flows is consistent with that used in the contractual maturity analysis below. Liquidity needs are monitored in various time bands, on a week-to-week basis, as well as on the basis of a rolling 30-day projection. Cash requirements are compared to available sources of cash in order to

determine headroom or any shortfalls. This analysis shows that available sources of cash are expected to be sufficient over the lookout period.

The Organization's objective is to maintain cash and marketable securities to meet its liquidity requirements for 30-day periods at a minimum. Funding for long-term liquidity needs is additionally secured by an adequate amount of committed contributions and the ability to sell investments.

Contractual maturity analysis – The Organization's liabilities have remaining contractual maturities (including interest payments where applicable) as summarized below:

	Current			Non-current	
	within 1 months	**1 to 6 months**	**6 to 12 months**	**1 to 5 years**	**later than 5 years**
Accounts payable					
Transfers payable					
Finance lease obligations					
Other liabilities					
Total					

The Organization considers expected cash flows from financial assets in assessing and managing liquidity risk, in particular its cash resources and contribution receivables. The Organization's existing cash resources and contribution receivables significantly exceed the current cash outflow requirements.

7.7.2.3 Market risk – sensitivity analysis

The United Nations will disclose:

- A **sensitivity analysis** for **each type of market risk** to which the United Nations is exposed at the end of the reporting period, showing how surplus or deficit and net assets would have been affected by changes in the relevant risk variable that were reasonably possible at that date;
- The **methods and assumptions** used in preparing the sensitivity analysis; and
- Changes from the previous period in the methods and assumptions used, and the reasons for such changes.

This disclosure should be based on reasonably possible changes and not on a 'worst case scenario' or 'stress test'. Risk variables that are relevant to disclosing market risk include, but are not limited to:

- The yield curve of market interest rates. It may be necessary to consider both parallel and non-parallel shifts in the yield curve.
- Foreign exchange rates.

The United Nations will need to disclose a sensitivity analysis for interest rate risk for each currency in which there is material exposures to interest rate risk. Similarly, a sensitivity analysis is disclosed for each currency to which the United Nations has significant exposure.

It should be noted that for the purposes of disclosing a sensitivity analysis for foreign currency risk, **translation related risk is not taken into account**. This is because foreign currency risk can only arise on financial instruments that are denominated in a currency other than the functional currency in which they are measured.

Example - Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. The majority of interest rate exposure arises on investments in debt securities Most of the investments in debt securities carry fixed interest rates and mature within five years. As at 31 December 2014 and 2013 the average durations of the investments were [ ] years and [ ] years, respectively.

The followings table demonstrates the sensitivity of interest rate on net assets for significant underlying investment currency based on the shift in the overall yield curve due to the assumed changes in interest rates:

Shift in yield curve (Basis points)	Change in fair value (USD millions)			
	at 31 December 2014		at 31 December 2013	
	USD	EURO	USD	EURO
-200				
-150				
-100				
-50				
0				
50				
100				
150				
200				

In practice, the actual results may differ from the sensitivity analysis below and the difference could be significant.

Example – Currency risk

The Organizations currency risk arises primarily from foreign currency-denominated receivables, liabilities, and forecast cash flows in foreign currencies. Owing to the geographical distribution the Organization is exposed to foreign currency exchange movements, primarily in European, Japanese and other Asian and Latin American currencies.

Monetary assets and liabilities other than investment in Cash Pools denominated in currency other than USD as at 31 December 2014 is presented in the table below:

(USD)	**EURO**	**CHF**	**Others**
Cash and cash equivalents			
Term deposits			
Contribution receivable			
Other accounts receivable			
Loans receivable			
Other assets			
Derivatives			

(USD)	EURO	CHF	Others
Other financial liabilities at amortized cost			
Accounts payable			
Borrowings			
Other liabilities			
Derivatives			
Net			

The following table indicates the currencies to which the Organisation had significant exposure at 31 December 201x on its monetary financial assets and liabilities. The analysis calculates the effect of a reasonably possible movement of the currency rate against the USD on net asset and on surplus and deficit with all other variables held constant.

Currency	Change in currency rate	Effect on net asset and on surplus and deficit for the year (relates to monetary financial instruments)	
		Current year	Previous year
EURO	+5%		
CHF	+8%		

There is no sensitivity effect on other comprehensive surplus and deficit as the Organization has no assets classified as available-for sale or designated hedging instruments. An equivalent decrease in each of the aforementioned currencies against the USD would have resulted in an equivalent but opposite impact.

7.8 Cash Pools financial information

Cash Pools financial information should include the following:

- Statement of Financial Position and Statement of Financial Performance;
- Significant accounting policy; and
- Financial risk management disclosures including sensitivity analysis.

Audited Cash Pools financial information should be used as input by Pool participants to incorporate Cash Pools related information.

Pool participants should disclose information with regards to Cash Pool investments in a separate note in their financial statements.

8 APPENDICES

8.1 Case study – Voluntary contribution receivable

Facts A:

The United Nations will receive a voluntary funding from Charity fund XYX of $1,000,000 to support the implementation and monitoring of projects specified in the United Nations Flash Appeal for assistance to Country A. First installment of $500,000 was received on the date of signing the agreement upon request from the United Nations on 30 November 2013 and the balance of the funding was due on 30 November 2014.

Accounting analysis on signing the agreement:

On the basis of the signed, binding agreement, an asset of $1,000,000 should be recognized. As the agreement imposes no stipulation on the transferred asset, there is no liability requiring recognition. Instead, revenue for the increase in net assets of $1,000,000 is recognized with a corresponding receivable on the date of the signing of the binding agreement (30 November 2014). Since the next installment is receivable in one year, the impact of time value of money is not expected to be material.

Journal entries:

30-Nov-13	Dr	Voluntary contribution receivable	1,000,000	
	Cr	Voluntary contribution - revenue		1,000,000
30-Nov-13	Dr	Bank	500,000	
	Cr	Voluntary contribution receivable		500,000

Facts B:

Similar fact pattern as fact A. The United Nations did not receive the remaining balance on 30 November 2014 and expects to receive the remaining balance within one year.

Accounting analysis while compiling financial statements for the year ended 31 December 2014:

Since the amount is one month overdue and there are no specific impairment indicator with regards to Charity fund XYX until the date subsequent events were assessed at the United Nations for the purpose of financial statements for the year ended 31 December 2014 accordingly no further accounting is required.

Journal entries: No entries required for year ended 31 December 2014

Facts C:

Similar fact pattern as Facts A and B. The United Nations did not receive the remaining balance as of 30 November 2015. However based on discussion with Charity fund XYZ the United Nations was assured that the funds will be received.

Accounting analysis while compiling financial statements for the year ended 31 December 2015:

The amount is now overdue for more than one year. As per the United Nations IPSAS policy for assessment of receivable, it was concluded that based on the discussion with the Charity fund XYZ and other facts and circumstances that the United Nations will get the funds within one year.

Based on specific identification the receivable was not impaired, however this receivable will be assessed for impairment on a collective basis along with other receivables based on aging analysis.

In accordance with the United Nations Policy Framework, since this receivable is outstanding for more than one year 25% of 500,000 i.e. $125,000 will be provided based on aging analysis in the financial statements for the year ended 31 December 2015.

Journal entries:

31-Dec-15	Dr	Bad Debt expense	125,000	
	Cr	Allowance for doubtful receivables		125,000

Facts D (Situation I):

Similar fact pattern as Facts A, B and C. The United Nations did not receive the remaining balance as of 31 December 2016 and the Charity fund XYZ has applied for bankruptcy due to financial difficulties during 2016.

Accounting analysis while compiling financial statements for the year ended 31 December 2016:

Since there is an objective evidence of impairment and the borrower is experiencing financial difficulties, the United Nations has evaluated that the probability of receiving the money is remote and decided to create a 100% specific provision for the receivable.

Accordingly an additional provision of $375,000 will be created for the year ended 31 December 2016.

Journal entries:

31-Dec-16	Dr	Bad Debt expense	375,000	
	Cr	Allowance for doubtful receivables		375,000

Facts E (Situation I):

Similar fact pattern as Facts A, B, C and D (Situation I). The United Nation receives $125,000 at the end of bankruptcy and winding up proceedings of Charity fund XYZ on 1 July 2017.

Accounting analysis while compiling financial statements for the year ended 31 December 2017:

The Executive Body approved the write off of the balance outstanding funds of $375,000 as the Charity Fund XYZ is no longer in existence.

Journal entries:

1-Jul-17	Dr	Bank	125,000	
	Cr	Voluntary contribution receivable		125,000
1-Jul-17	Dr	Allowance for doubtful debts	125,000	
	Cr	Bad Debt expense		125,000
1-Jul-17	Dr	Allowance for doubtful debts	375,000	
	Cr	Voluntary contribution receivable		375,000

Facts D (Situation II):

Similar fact pattern as Facts A, B and C. As of 31 December 2016, the United Nations has not received the remaining balance. The United Nations renegotiates with the Charity fund XYZ which was undergoing financial difficulties. A new agreement was signed wherein it was agreed that the United Nations will receive $100,000 annually for next four years starting from 31 December 2017 and received $100,000 on 31 December 2016.

Accounting analysis while compiling financial statements for the year ended 31 December 2016:

The United Nations should make specific assessment based on the renegotiated terms for the year ended 31 December 2016.

The value of the renegotiated terms will be the present value of future payments discounted at the current market interest rate of 6% for similar type of loan. Present value of four annually payments of $100,000 discounted at 6% equals $346,511 is calculated as follows.

Year	Cash flow	Discounted at 6%
1	100,000	94,340
2	100,000	89,000
3	100,000	83,962
4	100,000	79,209
	Total	346,511

An impairment review should be carried out at each reporting date. If, in subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss should be reversed, however the reversal should not result in a carrying amount of the financial asset that exceeds what the amortized cost would have been had the impairment not been recognized at the date the impairment is reversed.

During the year, cash received of $100,000 on December 31, 2016 should be recognized and the closing balance of restructured receivable will be $346,511.

Allowance for doubtful debts of $125,000 should be reversed consequent to the renegotiated terms. Additionally an allowance for change in estimated cash flow of $53,489 should be recognized to reflect the present value impact of changed in estimated cash flows.

Net impact on income statement will be $71,511 ([$346,511] – [$500,000-125,000-100,000)].

Journal entries:

31-Dec-16	Dr	Bank	100,000	
	Cr	Voluntary contribution receivable		100,000
31-Dec-16	Dr	Allowance for doubtful receivables	125,000	
	Cr	Bad Debt expense		125,000
31-Dec-16	Dr	Other expenses	53,489	
	Cr	Allowance for change in estimated cash flow		53,489

Facts E (Situation II):

Similar fact pattern as Facts A, B, C and D (Situation II). The United Nation receives $125,000 at the end of bankruptcy and winding up proceedings of Charity fund XYZ on 1 July 2017.

Accounting analysis while compiling financial statements for the year ended 31 December 2016:

On 1 July 2017 the carrying value of the receivable will be $356,906.33 ($346,511 plus the accrued interest @6% for six months).

The Executive Body approved the write off of the balance outstanding funds of $231,906 as the Charity Fund XYZ is no longer in existence.

Journal entries:

1-Jul-17	Dr	Allowance for change in estimated cash flow	10,395	
	Cr	Other miscellaneous income		10,395

1-Jul-17	Dr	Bank	125,000	
	Cr	Voluntary contribution receivable		125,000
1-Jul-17	Dr	Bad Debt expense	231,906	
	Dr	Allowance for change in estimated cash flow	43,094	
	Cr	Voluntary contribution receivable		275,000

8.2 Case study – Impairment of loan

Part A:

On 1 January 2015, The United Nations provides a 10 year $1 million loan. The loan is repaid in equal annual payments of $142,378 through to maturity date at 31 December 2024.

The loan was provided to fund a housing development project in a developing country. The borrower does not have an option to pre-pay the loan.

The loan has been classified as loans and advances and will be accounted at amortized cost using effective interest rate.

Computation of effective interest rate is as follows:

Year	Cash flow
1-Jan-15	(1,000,000)
31-Dec-15	142,378
31-Dec-16	142,378
31-Dec-17	142,378
31-Dec-18	142,378
31-Dec-19	142,378
31-Dec-20	142,378
31-Dec-21	142,378
31-Dec-22	142,378
31-Dec-23	142,378
31-Dec-24	142,378
IRR	7.00%

In calculating the effective interest rate that will apply over the term of the loan at a constant rate on the carrying amount, the discount rate necessary to equate 10 annual payments of $142,378 to the initial carrying amount of $1,000,000 is approximately 7%.

The carrying amount of the loan over the period to maturity will, therefore, be as follows:

Year	Cash in flows	Interest Income @ 7%	Carrying value
1-Jan-15			1,000,000
31-Dec-15	142,378	70,000	927,622
31-Dec-16	142,378	64,934	850,178
31-Dec-17	142,378	59,513	767,313
31-Dec-18	142,378	53,712	678,647
31-Dec-19	142,378	47,506	583,775
31-Dec-20	142,378	40,865	482,262
31-Dec-21	142,378	33,759	373,642
31-Dec-22	142,378	26,155	257,419
31-Dec-23	142,378	18,019	133,061
31-Dec-24	142,378	9,317	0
	1,423,780	423,780	

Part B

At 31 December 2017 it became clear that as a result of structural changes in the project plan of housing development project, the borrower was in financial difficulties hence the United Nations does not expect to receive the annual installments as planned.

Based on the circumstances, the United Nations expects to receive $800,000 at the end of 31 December 2024

At 31 December 2017, the loan's amortized carrying value, calculated at the original effective rate of 7%, amounted to $767,313.

The present value of the payments of $800,000 due on 31 December 2024 discounted at the original effective interest rate of 7% amounts will be calculated as follows:

Present value = $800,000 /(1. 07)^ = $ 498,198

Accordingly, the United Nations recognizes an impairment loss of $269,115 (767,313 – 498,198) in Statement of Financial Performance on 31 December 2017. Therefore, the carrying amount is written down by the amount of the impairment loss.

Following recognition of the impairment loss at 31 December 20X9, the amortized cost amounted to $498,198.

On the assumption that cash inflows will occur as expected, the amortization schedule based on the revised cash flows and the original discount rate is shown below:

Year	Cash in flows	Interest Income @ 7%	Carrying value
31-Dec-17			498,198

31-Dec-18		34,874	533,073
31-Dec-19		37,315	570,388
31-Dec-20		39,927	610,315
31-Dec-21		42,722	653,038
31-Dec-22		45,713	698,750
31-Dec-23		48,913	747,663
31-Dec-24	800,000	52,337	0
Total	800,000	301,802	

8.3 Case study – Currency forward contract

8.3.1 Scenario 1 – Gain on currency forward contract

On 1 November 2013, the United Nations entered into a contract to purchase CHF 10 million at a 180-days forward exchange rate. Rates for USD/CHF at inception, year-end and settlement date are as follows:

If USD/CHF = 0.95, then it takes 0.95 Swiss Franc to buy 1 USD.

	1 Nov 2013	31 Dec 2013	30 April 2014
Spot Rate	0.92	0.90	**0.88**
120-days forward	0.93	**0.91**	0.89
180-days forward	**0.95**	0.92	0.90

The United Nations has purchase CHF on 1 November 2013. CHF has appreciated from 1 November 2013 to 30 April 2014; accordingly the United Nations has made a gain on this forward contract.

Value of the forward contract at inception, year-end and settlement date is follows:

Date	USD / CHF	Sell USD	Buy CHF	Fair value of contract	Rate considered
Nov. 1, 2013	0.95	10,526,316	10,000,000		180-days forward
Dec. 31,2013	0.91	10,989,011	10,000,000	462,695	120-days forward
April 30,2014	0.88	11,363,636	10,000,000	837,321	Spot rate

Journal entries

1 November 2013 – transaction date
At the transaction date the forward contract will have a fair value of zero.

31 December 2013 – Period end

Dr	Derivative forward asset	462,695		Recognize the derivative asset.
Cr	Derivative gain - unrecognized		462,695	Recognize the derivative gain.

At April 30, 2014 – On settlement

Actual buying of CHF and settlement of forward contract

Dr	Bank (CHF Account)	11,363,636		Receipt of contracted amount (in USD).
Cr	Bank (USD Account)		526,316	Settlement payment from bank.
Dr	Derivative gain - unrecognized	462,695		Convert unrecognized gain…
Cr	Derivative gain - recognized		462,695	…to a recognized gain.
Cr	Derivative gain - recognized		374,625	Recognize the remaining gain.
Cr	Derivative forward asset		462,695	Extinguish the derivative asset.

Summary of impact:

Total settlement money in USD paid to bank for CHF 10 million = $10,526,316 i.e. at the original forward rate of 0.95. Therefore, recognition of gain is as follows:

Gain recognized in 2013	462,695
Gain recognized in 2014	374,625
Total gain on the transaction	**837,321**

8.3.2 SCENARIO 2 – LOSS ON CURRENCY FORWARD CONTRACT

On 1 November 2013, the United Nations entered into a contract to purchase CHF 10 million at a 180-days forward exchange rate. Rates for USD/CHF at inception, year end and settlement date are as follows:

If USD/CHF = 0.95, then it takes 0.95 Swiss Franc to buy 1 USD.

	1 Nov 2013	31 Dec 2013	30 April 2014
Spot Rate	0.92	0.95	**0.97**
120-days forward	0.93	**0.96**	0.98
180-days forward	**0.95**	0.97	0.99

The United Nations has purchase CHF on 1 November 2013. CHF has depreciated form 1 November 2013 to 30 April 2014; accordingly the United Nations has made a loss on this forward contract.

Value of the forward contract at inception, year end and settlement date is follows:

Date	USD / CHF	Sell USD	Buy CHF	Fair value of contract	Rate considered
Nov. 1, 2013	0.95	10,526,316	10,000,000		180-days forward

Dec. 31,2013	0.96	10,416,667	10,000,000	109,649	120-days forward
April 30,2014	0.97	10,309,278	10,000,000	217,038	Spot rate

Journal entries

1 November 2013 – transaction date
At the transaction date the forward contract will have a fair value of zero.

31 December 2013 – Period end

Dr	Derivative loss - unrecognized	109,649		Recognize the derivative loss.
Cr	Derivative forward liability		109,649	Recognize the derivative liability.

At April 30, 2014 - On settlement

Actual buying of CHF and Settlement of forward contract

Dr	Bank (CHF)	10,309,278		Receipt of contracted amount (in USD).
Cr	Bank (USD)		10,526,316	Settlement payment from bank.
Dr	Derivative loss - recognized	109,649		Convert unrecognized loss to a…
Cr	Derivative loss - unrecognized		109,649	… recognized loss.
Dr	Derivative forward liability		109,649	Extinguish the derivative liability.
Dr	Derivative loss - recognized	107,389		Recognize the remaining loss.

Summary of impact:

Total settlement money in USD paid to bank for CHF 10 million = $10,526,316 i.e. at the original forward rate of 0.95. Therefore, recognition of loss is as follows:

Loss recognized in 2013	109,649
Loss recognized in 2014	107,389
Total loss on the transaction	**217,038**

9 ANNEXURE

9.1 Embedded derivatives

Derivatives may be embedded within another type of contract, e.g. one or more derivative features may be embedded in a loan, lease, or purchase or sale contract. This is referred to as an '**Embedded Derivative'**, and the contract within which it is embedded is referred to as a '**Host' instrument**. The following list illustrates how the nature of a host contract and embedded derivative may be determined:

Instrument	Host contract	Embedded derivative
Debt paying interest quarterly based on an equity index	Debt instrument	4 forward contracts p.a. on equity index
A two-year fixed-quantity sales contract including maximum and minimum pricing limits	Purchase contract	Commodity price collar

An embedded derivative can arise from deliberate financial engineering, for example to make low interest-rate debt more attractive by including an equity-linked return. In other cases, they arise inadvertently through market practices and common contractual arrangements, such as leases and insurance contracts. Even purchase and sale contracts that qualify as executory contracts may contain embedded derivatives. The objective being to change the nature of cash flows that otherwise would be required by the host contract and effectively shift financial risks between the parties.

Searching for derivatives that may be embedded in the above hosts is more challenging. A thorough evaluation of a contract's terms must be performed to determine whether the contract contains an embedded derivative. Certain terms and phrases, however, may indicate that further assessment would be required. Such terms and phrases may include:

- Option to convert
- Pricing based on a formula
- The right to purchase / sell additional units
- Exchange / exchangeable into
- Indexed to / adjusted by / referenced to
- Premium / strike / limits
- The right to cancel / extend / repurchase / return

A derivative identified in a host contract needs further evaluation to determine whether it should be accounted for separately as a stand-alone derivative at fair value. Not all embedded derivatives need to be accounted for separately from the host contract.

If you feel that any contract is similar to a derivative or has an embedded derivative please consult the IPSAS team for further guidance.

9.2 Hedge accounting

What is hedging?

Entities face many types of operational risk. One of the most significant is financial risk. Example of financial risk includes commodity prices risk, such as the price of oil; interest rates; exchange rates; etc.

Entering into a derivative transaction with counterparty in the expectation that the derivative will eliminate or reduce exposure to a particular risk is referred to as hedging. Risk is reduced because the derivative's value or cash flows are expected, wholly or partly, to move inversely and, therefore, offset changes in the value or cash flows of the 'hedged position' or item.

Hedging in an economic sense, therefore, concerns the reduction or elimination of different financial risks such as price risk, interest rate risk, currency risk, etc, associated with the hedged position. In simple terms hedging is a risk management activity.

What is hedge accounting?

Once an entity has entered into a hedging transaction, it must be reflected in the financial statements of the entity. Accounting consistency can be achieved if both the hedging instrument and the hedged position are recognized and measured on symmetrical bases and offsetting gains and losses are reported in profit or loss in the same periods.

In simple terms hedge accounting is a technique that modifies the normal basis for recognizing gains and losses on associated hedging instruments and hedged items so that both are recognized in earnings in the same accounting period. Hedge accounting thus allows management to eliminate or reduce the income statement volatility that otherwise would arise if the hedged items and hedging instruments were accounted for separately, without regard to the hedge's business purpose.

IPSAS 29 provides a set of strict criteria that must be met before hedge accounting can be used. These require that the hedge relationship is designated and formally documented at inception. There are also requirements to demonstrate both at inception and throughout the life of the hedge that the hedge is highly effective. As a result, not all hedging activities undertaken by entities qualify for hedge accounting. Failure to meet any of the criteria whilst the hedge is in place results in the discontinuance of hedge accounting.

IPSAS 29 does not mandate the use of hedge accounting. It is a privilege not a right. Entities intending to use hedge accounting must have proper systems and procedures to monitor each hedging relationship. In practice many entities find these requirements too onerous and decide not to try to hedge account.

Currently the United Nations had decided not to apply hedge accounting for foreign currency forward contracts.

9.3 Subsequent measurement of debt instruments classified as available-for-sale

The subsequent measurement of available-for-sale financial assets with fixed and determinable payments is complicated by the fact that fair value changes are recognized in net assets, but interest income is recognized in each period in surplus or deficit using the effective interest method. In order to ensure that the change in fair value is correctly calculated at the measurement date, the United Nations will have to compare the instrument's clean price (the fair value of the instrument less accrued interest) with its amortized cost, also excluding accrued interest, at that date. Therefore, although the instrument is measured at fair value, the amortized cost must still be calculated using the effective interest method in order to determine the interest income component to be recognized in surplus or deficit.

Example – Debt security classified as available-for-sale investment

On 1 October 2013, ABC purchases a 10% $10 million 5 year bond with interest payable on 1 April and 1 October each year. The bond's purchase price is $10,811,100. The premium of $811,100 is due to market yield for similar bonds being 8%. There are no transaction costs. The effective interest rate is 8%. ABC classifies the bond as available-for-sale. ABC prepares its financial statements at 31 December. On 31 December 2013, the yield on bonds with similar maturity and credit risk is 7.75%. On 31 December 2013, the fair value of this bond calculated by discounting 10 semi-annual interest cash flows of $500,000 and principal payment of $10 million at maturity at the market rate of 7.75% amounted to $11,127,710.

Since the bond is classified as available-for-sale, it will be measured at fair value with changes in fair value recognized in net assets.

At 1 October 2013, the fair value of the bond is the consideration paid of $10,811,100 and the entry to record this is as follows:

Dr	Available-for-sale investment	10,811,100	
Cr	Cash		10,811,100

On 31 December 2013, the ABC will record interest income for the 3 months at the effective interest rate of 8%, that is, $10,811,100 × 8% × 3/12 = $216,222. Since the next coupon of $500,000 is due on 1 April 2014, the ABC will record a half-year interest accrual of $250,000. The difference of $33,778 between the interest income accrued and that recognized in the Statement of Financial Performance represents the amortization of the premium. The entry to record the interest income on 31 December 2013 is as follows:

Dr	Available-for-sale investment (accrued interest)	250,000	
Cr	Available-for-sale investment (premium)	33,778	
Cr	Statement of Financial Performance – interest income		216,222

The bond's amortized cost at 31 December 2013 is, therefore, $10,777,322 (10,811,100 – 33,778)

The fair value of the bond at 31 December 2013 is $11,127,710. This includes the accrued interest of $250,000. To calculate the clean price of the bond, the accrued income is deducted from the fair value. Therefore, the clean price of the bond is $10,877,710.

A comparison of the clean price of the bond and its amortized cost at 31 December 2013 results in a gain as follows:

Fair value of bond at 31 December 2013– clean price	10,877,710
Amortized cost of bond at 31 December 2013	10,777,322
Change in value – Unrealized gain	100,388

The entry to record the gain at 31 December 2013 is as follows:

Dr	Available-for-sale investments	100,388	
Cr	Net revenue directly recognized in net assets		100,388

The movement in available-for-sale asset is shown below:

At 1 October 2013– Fair value (inclusive of premium)	10,811,100
Accrued income (reflected in fair value)	250,000
Amortization of premium	(33,778)
Fair value adjustment – gain	100,388
At 31 December 20X5 – Fair value	11,127,710
Recognized in surplus or deficit– income	216,222
Recognized in net assets – gain	100,388
Total change in fair value	316,610