

5. RECOGNITION AND MEASUREMENT OF COMMUNITY LOANS

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PURPOSE OF REPORT

1. The purpose of this report is to make a recommendation to the Audit and Risk Subcommittee on the recognition and measurement of loans provided to the community at lower-than-market rates. This recommendation has arisen from the Council's obligation to comply with NZ IAS 39, Financial Instruments: Recognition and Measurement.

EXECUTIVE SUMMARY

2. NZ IAS 39, requires initial measurement of a financial asset at its fair value, classifies financial assets into four categories and prescribes the accounting treatment under each category.
3. Under the Council's existing policy, community loans are granted at less than market rates.
4. The fair value of a long-term loan or receivable that incurs no interest, or interest at below commercial rates, can be estimated as the present value of all future cash receipts discounted using the rate of interest that the borrower would be charged by a commercially motivated lender for a similar instrument.
5. The need to estimate the fair value of community loans, both initially and annually, would be removed were the loans provided at market rates of interest, with an offset between the interest income generated at commercial rates and that generated at the beneficial rate, credited to the borrower by way of a grant.
6. This would also provide more transparency as to the true value of grants provided.
7. Under paragraph 9 of the standard, and using the first time adoption options under NZ IFRS 1, the option exists to designate loans upon transition to IFRS as either:
 - (a) Loans and receivables; or
 - (b) Available-for-sale financial instruments.
8. Designation will impact upon the measurement method used on transition to IFRS and subsequently.

FINANCIAL AND LEGAL CONSIDERATIONS

9. Obligation to comply with NZ IFRS.

STAFF RECOMMENDATIONS

10. It is recommended:
 - (a) That future community loans be granted at commercial rates, with the additional interest cost being returned to the borrower by way of a grant.
 - (b) That existing loans be amended to reflect commercial rates, backdated to 1 July 2005, and that the appropriate grants be given.
 - (c) That community loans be designated as Loans and Receivables at transition to IFRS, and annual amortisation and impairment testing occur thereafter.

BACKGROUND ON RECOGNITION AND MEASUREMENT OF COMMUNITY LOANS

11. The Council has resolved to adopt New Zealand International Financial Reporting Standards as from 1 July 2006 and, in preparation for this, staff have reviewed the existing accounting policies and procedures.

Analysis

12. This is provided in Appendix 1, Issue Paper 21, (attached), which was adopted by the IFRS Steering Committee on 3 February 2006.

OPTIONS

13. Continue to provide Community loans at below market rates with the subsequent annual adjustment and resulting impact on rates.
14. Provide Community Loans at market rates with a grant to offset the additional interest. The net financial position for both the Council and the borrower is unchanged, but there is greater transparency.
15. Combined with each of the above is the option to designate the loans as either Loans and Receivables or Available for Sale.