S02.04-SP-02-2-Effective rate method

I - Financial Instruments: General principles

2. Recognition, Impairment, Derecognition

2.2. Subsequent measurement

2.2.2. Amortized cost

Methodologies in respect of the effective rate method

1. Methodologies applied

1.1. Fixed rate debt

The application of the effective interest rate method for a fixed rate debt must be done using the excel file in HERE.

1.2. Variable rate debt

In this case, the application of the effective interest rate is substantially the same as that presented above. The only difference is to be found in the fact that the calculations must be reviewed for each period using the new variable interest rate. In this case, the calculations are not changed for the past and changes are only made for the future.

The application of the effective interest rate method for a variable rate debt must be done using the excel file in HERE.

1.3. The following items are required for the calculations:

- Issue date
- Maturity date
- Nominal amount
- Interest rate (fixed for fixed rate debt and variable for variable rate debt)
- Issue premium (where applicable)
- Redemption premium (where applicable)
- Issue expenses paid (transaction costs)

2. Analysis of embedded derivatives relating to debts

The early redemption options available to the issuer or investor must be analyzed in order to see whether they need to be recognized separately from the option.

3. Transfer of trade payables / financial debts

The putting in place of financing packages may result in the transformation of a trade payable into a financial debt.

For the purposes of illustration:

An entity enters into an agreement with a bank that contains the following provisions:

- The bank pays the amounts due by the entity to its suppliers in order to obtain rebates
- The entity will pay the bank the total amount, before rebates
- The entity receives 90% of the rebate granted by the supplier
- The bank retains 10% of the rebate granted by the supplier

The entity has no obligation to the supplier from the moment the bank pays the supplier. The amount due to the bank is no longer a trade payable (a debt in respect of a good purchased or a service provided) but rather a financial debt. So the debt is transferred to the "financial debt" line item.

5. Advances received from customers - L41160

Advance payments received from customers (transactions qualified as “Net Sales” or “Other Revenue”) correspond to amounts cashed in related to customers’ orders, where the delivery of the goods/services has not occurred yet (e.g. the goods/services is not invoiced not accrued as invoice to issue).

This type of advance is not related to an item recorded in the balance of trade receivables, but representing a cash inflow linked to the trade receivables, then this should be reported in a distinguished reporting line in the liabilities in the account L41160 (included in the Trade Working Capital). Indeed, in case of orders’ cancellation, the cash should be returned to the customer.

Once goods/services are delivered, and therefore invoiced (or accrued as invoice to issue), the advance should be matched to the invoice, in deduction of “ A41100-Trade receivables”.

Long-term advance payments:

Some advance payments received may be qualified as long-term, as they will be “consumed” over more than 12 months. In such case, the LT portion should be reported under "L16900-Other long-term liabilities".

In such case, the discount effect should be considered, and the correct analysis of the related cash flows. This kind of advance is usually framed into specific contracts, which need to be analyzed in the frame of the “Complex Contracts” procedure.

To validate the correct treatment of the cash flows of such LT advance, contact the consolidation team.