



**INTERNATIONAL FEDERATION
OF ACCOUNTANTS**

545 Fifth Avenue, 14th Floor Tel: (212) 286-9344
New York, New York 10017 Fax: (212) 286-9570
Internet: <http://www.ifac.org>

Agenda Item

8

DATE: JUNE 8, 2007
MEMO TO: MEMBERS OF THE IPSASB
FROM: MATTHEW BOHUN
SUBJECT: FINANCIAL INSTRUMENTS

OBJECTIVE OF THIS SESSION

To **review** the attached draft Exposure Draft proposing amendments to IPSAS 15, “Financial Instruments: Disclosure and Presentation,” and provide staff with directions for preparing a final draft ED for approval at the next IPSASB meeting.

AGENDA MATERIAL:

Papers

- 8.1 Draft ED XX, “Revisions to IPSAS 15, ‘Financial Instruments: Disclosure and Presentation’”
- 8.2 Issues Paper – Financial Instruments

ACTION REQUIRED

The IPSASB is asked to:

- **review** the attached draft Exposure Draft; and
- **provide** staff with directions for preparing a final draft ED.

BACKGROUND

At its March 2007 meeting the IPSASB discussed international developments in financial reporting of financial instruments. At that meeting the IPSASB concluded that it would amend IPSAS 15, “Financial Instruments: Disclosure and Presentation” to conform with the revised IAS 32, but not to proceed to develop IPSASs based on IAS 39 or IFRS 7 at this time. The IPSASB also concluded that, under the existing hierarchy, entities would be likely apply IAS 39 and IFRS 7 if recognizing and measuring financial instruments. The IPSASB reasoned that IAS 39 particularly, and IFRS 7 and IAS 32, were likely to be further amended by the IASB’s ongoing financial instruments project, and that it would require significant ongoing resources to keep pace with those changes. A project on recognition and measurement was added to the workplan for 2009, at which time there should be greater certainty as to the direction of the IASB in this area.

KEY ISSUES

Staff has prepared a draft Exposure Draft (item 8.1) proposing revisions to IPSAS 15. These revisions are based on the recent revisions to IAS 32 as a consequence of the IASB issuing IFRS 7, as well as other changes made by the IASB since its 1998 revision of IAS 32. The changes are shown in mark up to the existing IPSAS 15. Although there are quite extensive changes, these are necessary to align IPSAS 15 with IAS 32 and to prevent possible conflicts between IPSAS 15, IAS 39 and IFRS 7. All changes are consistent with the IPSASB's IFRS convergence strategy. The only realistic alternative to adopting the changes proposed is to withdraw IPSAS 15 in its entirety.

In developing the draft ED the staff, as directed, have excluded from the scope of the proposed IPSAS monetary gold, Special Drawing Rights in the International Monetary Fund (SDRs) and currency issued by the entity. The proposed Basis for Conclusions notes that addressing these issues is beyond the scope of the limited convergence project.

The issues paper at item 8.2 outlines the issues that motivated the establishment of this project and the issues addressed by the project.

Changes in IAS 32

In developing the draft exposure draft at item 8.1, staff has included all the changes made by the IASB to converge with IAS 32. Pending the conclusion of the conceptual framework project, staff has not identified any public sector specific reason for having different presentation requirements from those established in IAS 32. The main changes include:

- The scope of IPSAS 15 has been aligned to that of IAS 32 except that it is proposed that the scope IPSAS 15 exclude monetary gold, Special Drawing Rights (SDRs) in the International Monetary Fund (IMF) and currency issued by the entity. Addressing these matters is beyond the scope of this limited project and they may be addressed in a later project.
- A revised fundamental principle is established, which includes revising the definitions of a financial asset and a financial liability and the description of an equity instrument.
- The proposed IPSAS includes requirements for the classification of contracts to be settled in the entity's own equity instruments. This provision will normally only apply when an entity consolidates a partly privatized GBE.
- The proposed IPSAS eliminates the option to measure the liability component as a residual amount after separating the net assets/equity component. The proposed IPSAS requires any asset or liability component to be separated first and the residual amount is the amount of any net assets/equity component.
- The proposed IPSAS includes requirements relating to treasury shares. These requirements will normally only apply when an entity consolidates a partially privatized GBE.
- The proposed IPSAS includes guidance explaining that transaction costs incurred to complete a net assets/equity transaction are deducted from net assets/equity.

- The disclosure requirements previously set out in IPSAS 15 have been deleted.

Introduction and Basis for Conclusions

Staff has drafted both an Introduction and Basis for Conclusions. The Introduction has been adapted from the Introduction to IAS 32, and notes the main changes from the previous version of IPSAS 15. The Basis for Conclusions notes the IPSASB's reasons for amending IPSAS 15 and the reasons for varying from IAS 32. These variations are also noted in the Comparison with IAS 32.

Appendices

The draft ED contains four appendices. The Application Guidance in Appendix 1, was previously Appendix 2: Examples of the Application of the Standard". The appendix has been amended in line with amendments made to IAS 32, and, as with that standard, this appendix is an integral part of the standard. Given that this appendix is now part of the IPSAS, staff recommends placing it immediately after the standard.

Appendix 2 contains amendments to other IPSASs. This Appendix is an integral part of the IPSAS.

Appendix 3 Implementation Guidance, was previously Appendix 1 Implementation Guide. This appendix was developed by the IPSASB when preparing the superseded IPSAS 15. As this appendix is not an integral part of the IPSAS, it is located after Appendix 2.

Appendix 4 Illustrative Examples is the same as the equivalent appendix in IAS 32. However, it notes that the examples assume that the entity has adopted the accounting policy of recognizing and measuring financial instruments in accordance with IAS 39.

Specific Matters for Comment

Staff has included two proposed "Specific Matters for Comment". These relate to the scope exclusions for monetary gold, SDRs and currency issued by the entity. Staff would welcome any additional matters for comment that the IPSASB members consider should be included in the ED.

Next Steps

Agenda item 4, "Rules of the Road" proposes issues to be considered in developing a policy statement on international convergence of public sector financial reporting requirements. The draft exposure draft should also be reviewed in light of that agenda item and the discussions that will take place at the meeting on that paper.

The next steps are to review the draft Exposure Draft at item 8.1, identify any changes to be made to the draft ED, and provide staff with instructions to develop a final ED for approval at the meeting in November 2007.

ACTION: Staff recommend that the IPSASB review the IPSAS and provide instructions for preparing a final draft ED.
--

**Matthew Bohun
TECHNICAL MANAGER**

**ED XX REVISIONS TO IPSAS 15—FINANCIAL
INSTRUMENTS:
~~DISCLOSURE AND PRESENTATION~~**

Acknowledgment

This Exposure Draft of an International Public Sector Accounting Standard is drawn primarily from International Accounting Standard (IAS) 32 (revised ~~1998~~2006), “Financial Instruments: ~~Disclosure and~~ Presentation” published by the ~~International Accounting Standards Committee (IASC). The~~ International Accounting Standards Board (IASB), ~~and the International Accounting Standards Committee Foundation (IASCF) were established in 2001 to replace IASC. The International Accounting Standards (IASs) issued by IASC remain in force until they are amended or withdrawn by IASB.~~ Extracts from IAS 32 are reproduced in this publication of the ~~Public Sector Committee~~International Public Sector Accounting Standards Board of the International Federation of Accountants with the permission of ~~IASB~~International Accounting Standards Committee Foundation (IASCF).

The approved text of IASs is that published by IASB in the English language, and copies may be obtained directly from IASB Publications Department, 1st floor, 30 Cannon Street, London EC4M 6XH, United Kingdom.

E-mail: publications@iasb.org

Internet: <http://www.iasb.org>

IASs, exposure drafts and other publications of IASC and IASB are copyright of IASCF.

“IAS,” “IASB,” “IASC,” “IASCF” and “International Accounting Standards” are trademarks of IASCF and should not be used without the approval of IASCF.

Amendments required
to bring the
acknowledgement up
to date.

REQUEST FOR COMMENTS

The International Public Sector Accounting Standards Board, an independent standard-setting body within the International Federation of Accountants (IFAC), approved this Exposure Draft, *Revisions to IPSAS 15, Financial Instruments: Presentation*, for publication in Month 200X. This proposed International Public Sector Accounting Standard may be modified in light of comments received before being issued in final form.

Please submit your comments, preferably by email, so that they will be received by **Month DD, 200X**. All comments will be considered a matter of public record. Comments should be addressed to:

The Technical Director

International Public Sector Accounting Standards Board

International Federation of Accountants

277 Wellington Street West

Toronto, Ontario M5V 3H2, Canada

Email responses should be sent to: publicsectorpubs@ifac.org

Copies of this exposure draft may be downloaded free-of-charge from the IFAC website at <http://www.ifac.org>.

INTRODUCTION TO THE INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS

The International Federation of Accountants' International Public Sector Accounting Standards Board (IPSASB) develops accounting standards for public sector entities referred to as International Public Sector Accounting Standards (IPSASs). The IPSASB recognizes the significant benefits of achieving consistent and comparable financial information across jurisdictions and it believes that the IPSASs play a key role in enabling these benefits to be realized. The IPSASB strongly encourages governments and national standard-setters to engage in the development of its Standards by commenting on the proposals set out in these Exposure Drafts.

The IPSASB issues IPSASs dealing with financial reporting under the cash basis of accounting and the accrual basis of accounting. The accrual basis IPSASs are based on the International Financial Reporting Standards (IFRSs), issued by the International Accounting Standards Board (IASB), where the requirements of those Standards are applicable to the public sector. They also deal with public sector specific financial reporting issues that are not dealt with in IFRSs.

The adoption of IPSASs by governments will improve both the quality and comparability of financial information reported by public sector entities around the world. The IPSASB recognizes the right of governments and national standard-setters to establish accounting standards and guidelines for financial reporting in their jurisdictions. The IPSASB encourages the adoption of IPSASs and the harmonization of national requirements with IPSASs. Financial statements should be described as complying with IPSASs only if they comply with all the requirements of each applicable IPSAS.

Due Process and Timetable

An important part of the process of developing IPSASs is for the IPSASB to receive comments on the proposals set out in Exposure Drafts from governments, public sector entities, auditors, standard-setters and other parties with an interest in public sector financial reporting. Accordingly, each proposed IPSAS is first released as an Exposure Draft, inviting interested parties to provide their comments. Exposure Drafts will usually have a comment period of four months, although longer periods may be used for certain Exposure Drafts. Upon the closure of the comment period, the IPSASB will consider the comments received on the Exposure Draft and may modify the proposed IPSAS in the light of the comments received before proceeding to issue a final Standard.

Background

The IPSASB issued IPSAS 15, “Financial Instruments: Disclosure and Presentation” in December 2001. That IPSAS was based on IAS 32, “Financial Instruments: Disclosure and Presentation” issued by the International Accounting Standards Board in 1998. The IASB made limited amendments in 2001 that were not included in IPSAS 15, and issued a revised IAS 32 in December 2003. The IASB has also amended the IAS several times since then. Most recently, in August 2005, the IASB issued IFRS 7, “Financial Instruments: Disclosure” which removed the disclosure requirements from IAS 32 and added required disclosures that are different from those in IPSAS 15. The IPSASB has not issued an IPSAS establishing requirements for the recognition and measurement of financial instruments and does not intend to in the near term. In the absence of a specific IPSAS on a subject, IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” directs entities to develop accounting policies that are consistent with IPSASs and entities may refer to the recent pronouncements of other standard setters. The IPSASB is aware that many entities are referring to IAS 39, “Financial Instruments: Recognition and Measurement” in developing their accounting policies.

Background developed by Staff based on similar material in IASB’s ED and the conclusions of last meeting.

Consistent with its policy to converge with IFRSs, the IPSASB is now concerned that IPSAS 15 needs to be updated to remove inconsistencies from the IASB’s standards. Therefore, the IPSASB proposes to amend IPSAS 15 to be converged with IAS 32.

Purpose of the Exposure Draft

This Exposure Draft proposes amendments to IPSAS 15, “Financial Instruments: Disclosure and Presentation”.

Purpose of ED & Request for comments is standard text for EDs.

Request for Comments

The IPSASB welcomes comments on the amendments proposed in this Exposure Draft, particularly on any or all of the Specific Matters for Comment set out below. The IPSASB would prefer that respondents express a clear overall opinion on whether the Exposure Draft in general is supported and that this opinion be supplemented by detailed comments, whether supportive or critical, on the specific issues in the Exposure Draft. Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments and, where appropriate, make specific suggestions for any proposed changes to wording.

Specific Matters for Comment

The IPSASB would particularly value comment on the following items:

The specific matters for comment address only the scope exclusions requested at the last meeting. Any further specific matters members consider appropriate can be included.

1. It is proposed that Special Drawing Rights and monetary gold be excluded from the scope of the IPSAS. These items are treated as financial instruments in the statistical bases of reporting. However, as currently defined they do not meet the definition of a financial asset because there is no counterparty. The IPSASB is aware that most public sector entities adopt accounting policies in relation to these items that are consistent with the principles established in IPSASs and the statistical bases of reporting and does not consider development of specific requirements in relation to these assets to be an urgent matter.
2. It is proposed that currency issued by the entity be excluded from the scope of the IPSAS. Monetary authorities are often treated as GBEs and as such prepare their financial statements in accordance with IFRSs. Monetary authorities are, however, usually included in the consolidated financial statements of national governments, therefore the currency issued by the monetary authority is a liability of the government that controls it. Neither IFRSs nor IPSASs address issuing of currency. The IPSASB is aware that most public sector entities adopt accounting policies in relation to the issue of currency that are consistent with the principles established in IPSASs, the statistical bases of reporting and international agreements on central banking and does not consider the development of specific requirements in relation to the issue of currency to be an urgent matter.

~~December 2001~~ Month 20XX

ED XX REVISIONS TO IPSAS 15—FINANCIAL INSTRUMENTS: DISCLOSURE AND PRESENTATION

CONTENTS

	Paragraph
<u>Introduction</u>	IN1–IN16
Objective.....	1–2
Scope	34–138
Definitions	149–172
Presentation	182–5947
Liabilities and Net Assets/Equity	182–3528
Classification of Compound Instruments by the Issuer <u>No contractual obligation to deliver cash or another financial asset</u>	2029–2835
Interest, Dividends, Losses and Gains <u>Settlement in the entity's own equity instruments</u>	2936–3238
Offsetting of a Financial Asset and a Financial Liability <u>Contingent settlement provisions</u>	3339–47
Settlement options	34–35
Compound financial instruments	36–41
Treasury shares	42–43
Interest, dividends or similar distributions, losses and gains	44–50
Offsetting of a financial asset and a financial liability	51–59
Disclosure	48–101
Disclosure of Risk Management Policies	50–53
Terms, Conditions and Accounting Policies	54–62
Interest Rate Risk	63–72
Credit Risk	73–83
Fair Value	84–94
Financial Assets Carried at an Amount in Excess of Fair Value	95–97

Hedges of Anticipated Future Transactions	98-100
Other Disclosures	101
Transitional Provision	102
Effective Date	60103-61104
Appendix 1: Implementation Guide <u>Application Guidance</u>	AG1-AG38
Appendix 2: Examples of the Application of the Standard <u>Amendments to other IPSASs</u>	A1 – A2
Appendix 3: Examples of Disclosure Requirements <u>Implementation Guide</u>	
<u>Appendix 4: Illustrative Examples</u>	IE1-IE50
<u>Basis for Conclusions</u>	BC1-BC9
Comparison with IAS 32	

Table of contents revised consistent with
revisions to the IPSAS.

International Public Sector Accounting Standard 15, “Financial Instruments: Presentation” is set out in paragraphs 1 – 61. All the paragraphs have equal authority except as noted otherwise. IPSAS 15 should be read in the context of its objective, the Basis for Conclusions, and the “Preface to International Public Sector Accounting Standards”. IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

This is now
standard text in
all IPSASs.

Introduction

Reasons for revising IPSAS 15

- IN1. International [MSOffice1] Public Sector Accounting Standard IPSAS 15, “Financial Instruments: Presentation” replaces IPSAS 15, “Financial Instruments: Disclosure and Presentation” (issued 2001) and should be applied for annual periods beginning on or after Month DD, 200X. Earlier application is encouraged.
- IN2. The IPSASB developed this revised IPSAS 15 as part of its project to converge international financial reporting requirements. The superseded IPSAS 15 was based on IAS 32, “Financial Instruments: Disclosure and Presentation” revised in 1998. The International Accounting Standards Board has amended and revised IAS 32 several times since 1998, most recently in August 2005 when it issued IFRS 7, “Financial Instruments: Disclosure” which removed the disclosure requirements from IAS 32 issuing new disclosure requirements in the IFRS.
- IN3. The IPSASB’s main objective in amending IPSAS 15 is to ensure consistency with the revised IAS 32. Disclosure, recognition and measurement of financial instruments will be considered at a later time.

The Main Changes

- IN4. The main changes from the previous version of IPSAS 15 are described below.

Scope

- IN5. The scope of the IPSAS has been aligned to that of IAS 32 except that it specifically excludes Special Drawing Rights in the International Monetary Fund, monetary gold and currency issued by the entity. These are public sector specific financial instruments that are not addressed in the IFRSs. The limited objective of this project precludes the IPSASB from developing requirements relating to these items at this time.

Principle

- IN6. In summary, when an issuer determines whether a financial instrument is a financial liability or an equity instrument, the instrument is an equity instrument if, and only if, both conditions (a) and (b) are met.
- (a) The instrument includes no contractual obligation:

- (i) To deliver cash or another financial asset to another entity; or
 - (ii) To exchange financial assets or financial liabilities with another entity under conditions that is potentially unfavorable to the issuer.
- (b) If the instrument will or may be settled in the issuer's own equity instruments, it is:
 - (i) A non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or
 - (ii) A derivative that will be settled by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose, the issuer's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the issuer's own equity instruments.

IN7. In addition when an issuer has an obligation to purchase its own shares for cash or another financial asset, there is a liability for the amount that the issuer is obliged to pay.

IN8. The definitions of a financial asset and a financial liability, and the description of an equity instrument, are amended consistently with this principle.

Classification of contracts settled in an entity's own equity instruments

IN9. The classification of derivative and non-derivative contracts indexed to, or settled in, an entity's own equity instruments has been clarified consistently with the principle in paragraph IN6 above. In particular, when an entity uses its own equity instruments 'as currency' in a contract to receive or deliver a variable number of shares whose value equals a fixed amount or an amount based on changes in an underlying variable (e.g. a commodity price), the contract is not an equity instrument, but is a financial asset or a financial liability.

Puttable instruments

IN10. IPSAS 15 incorporates guidance on financial instruments or rights redeemable by the holder. Consequently, a financial instrument that gives

the holder the right to put the instrument back to the issuer for cash or another financial asset (a 'puttable instrument') is a financial liability of the issuer.

Contingent settlement provisions

IN11. A financial instrument is a financial liability when the manner of settlement depends on the occurrence or non-occurrence of uncertain future events or on the outcome of uncertain circumstances that are beyond the control of both the issuer and the holder. Contingent settlement provisions are ignored when they apply only in the event of liquidation of the issuer or are not genuine.

Settlement options

IN12. Under IPSAS 15, a derivative financial instrument is a financial asset or a financial liability when it gives one of the parties to it a choice of how it is settled, unless all or the settlement alternatives would result in it being an equity instrument.

Measurement of the components of a compound financial instrument on initial recognition

IN13. The revisions eliminate the option previously in IPSAS 15 to measure the liability component of a compound financial instrument on initial recognition either as a residual amount after separating the net assets/equity component, or by using a relative-fair-value method. Thus, any asset and liability components are separated first and the residual is the amount of any net assets/equity component. These requirements for separating the liability and equity components of a compound financial instrument are conformed to the definition of an equity instrument as a residual.

Treasury Shares

IN14. The acquisition or subsequent resale by an entity of its own equity instruments does not result in a gain or loss for the entity. Rather it represents a transfer between those holders of equity instruments who have given up their equity interest and those who continue to hold an equity instrument.

Interest, dividends and similar distributions, losses and gains

IN15. IPSAS 15 incorporates guidance on the costs of a net assets/equity transaction. Transaction costs incurred as a necessary part of completing a net assets/equity transaction are accounted for as part of that transaction and are deducted from net assets/equity.

Disclosure

~~IN4-IN16.~~ IPSAS 15 no longer incorporates requirements for disclosures relating to financial instruments. Guidance on disclosures relating to disclosures of financial instruments can be found in international or national accounting standards addressing disclosure of financial instruments.

The introduction is consistent with the decisions made at the March 2007 meeting and with a similar introduction in IAS 32.

The standards, which have been set in bold type, should be read in the context of the commentary paragraphs in this Standard, which are in plain type, and in the context of the “Preface to International Public Sector Accounting Standards.” International Public Sector Accounting Standards are not intended to apply to immaterial items.

Deleted in accordance with revised policy established during Improvements

~~Some public sector entities such as national governments and public sector financial institutions may hold a wide range of financial instruments. However, some individual government agencies may not issue or hold a wide range of instruments. In such cases, the Standard will have limited application and preparers of financial statements will need to identify those aspects of the Standard that apply to them. The purpose of the implementation guide located in Appendix 1 is to assist preparers in this task.~~

Now paragraph 1, below.

Objective

~~1. The dynamic nature of international financial markets has resulted in the widespread use of a variety of financial instruments ranging from traditional primary instruments, such as bonds, to various forms of derivative instruments, such as interest rate swaps. Public sector entities use a wide range of financial instruments from simple instruments such as payables and receivables to more complex instruments (such as cross-currency swaps to hedge commitments in foreign currencies) in their operations. To a lesser extent, public sector entities may issue equity instruments or compound liability/equity instruments. This may occur where an economic entity includes a partly privatized Government Business Enterprise (GBE) that issues equity instruments into the financial markets or where a public sector entity issues debt instruments that convert to an ownership interest under certain conditions.~~

Deleted from IAS 32.

1. Some public sector entities such as national governments and public sector financial institutions may hold a wide range of financial instruments. However, some individual government agencies may not issue or hold a wide range of such instruments. In such cases, the Standard will have limited application and preparers of financial statements will need to identify those aspects of the Standard that apply to them. The purpose of the Implementation Guide located in Appendix 3 is to assist preparers in this task.

Previously an unnumbered objective paragraph.

4.2. The objective of this Standard is to establish principles for presenting enhance financial statement users’ understanding of the significance of on balance sheet and off balance sheet financial instruments as liabilities to a government’s or or net assets/equity and for offsetting financial assets and financial

Amended as per IASB improvements project, ref. IAS 32.2.

~~liabilities. It applies to the classification of financial instruments from the perspective of the issuer, into other public sector entity's financial position assets, financial liabilities and equity instruments; the classification of related interest, dividends or similar distributions, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset, performance and cash flows. In this Standard, references to "balance sheet" in the context of "on-balance sheet" and "off-balance sheet" have the same meaning as "statement of financial position." The Standard prescribes certain requirements for presentation of on-balance sheet financial instruments and identifies the information that should be disclosed about both on-balance sheet (recognized) and off-balance sheet (unrecognized) financial instruments. The presentation standards deal with the classification of financial instruments between liabilities and net assets/equity, the classification of related interest, dividends, revenues and expenses, and the circumstances in which financial assets and financial liabilities should be offset. The disclosure standards deal with information about factors that affect the amount, timing and certainty of an entity's future cash flows relating to financial instruments and the accounting policies applied to the instruments. In addition, the Standard encourages disclosure of information about the nature and extent of an entity's use of financial instruments, the financial purposes that they serve, the risks associated with them and management's policies for controlling those risks.~~

Deleted as per IASB improvements project, ref IAS 32.3. IAS 32 refers to IAS 39 at this point, staff propose that the IPSAS remain silent on recognition and measurement.

Scope

~~1.3.~~ **An entity ~~which that~~ prepares and presents financial statements under the accrual basis of accounting ~~should shall~~ apply this Standard for the presentation and disclosure of financial instruments.**

Amended as per IPSASB improvements project.

~~2.4.~~ **This Standard applies to all public sector entities other than Government Business Enterprises.**

~~3.5.~~ **The "Preface to International Public Sector Accounting Standards" issued by the International Public Sector Accounting Standards Board (IPSASB) explains that Government Business Enterprises (GBEs) apply International Financial Reporting Standards (IFRSs) which are issued by the International Accounting Standards Board (IASB). GBEs are defined in IPSAS 1, "Presentation of Financial Statements".**

~~4.6. This Standard should shall be applied by all entities to in presenting and disclosing information about all types of financial instruments, both recognized and unrecognized, other than except:~~

Amended as per IASB improvements project, ref. IAS 32.4, except for (g), (h) and (i).

~~(a) Interests in controlled entities, as defined in International Public Sector Accounting Standard (IPSAS) 6, “Consolidated and Separate Financial Statements”~~

~~(b) Interests in associates, as defined in IPSAS 7, “Accounting for Investments in Associates;”~~

~~(c)(a) Interests in joint ventures, as defined in Those interests in controlled entities, associates and joint ventures that are accounted for in accordance with IPSAS6, “Consolidated and Separate Financial Statements”, IPSAS 7, “Investments in Associates” or IPSAS 8, “Interests in Joint Ventures;”. However, in some cases IPSAS 6, IPSAS 7 or IPSAS 8 permits an entity to account for an interest in a controlled entity, associate or joint venture using international or national accounting standards addressing the recognition and measurement of financial instruments; in those cases, entities shall apply the disclosure requirements in IPSAS 6, IPSAS 7 or IPSAS 8 in addition to those in this Standard. Entities shall also apply this Standard to all derivatives linked to interests in controlled entities, associates and joint ventures;~~

~~(d)(b) Employers’ rights and obligations under employee benefit plans, to which IPSAS XX, “Employee Benefits” applies;~~

~~(c) Contracts for contingent consideration in an entity combination (see international or national standards addressing entity combinations). This exemption only applies to the acquirer.~~

~~(d) Obligations arising under insurance contracts. However, this standard applies to derivatives that are embedded in insurance contracts if the international or national accounting standard addressing recognition and measurement of financial instruments applied by the entity requires the entity to account for them separately. Moreover, an issuer shall apply this Standard to financial guarantee contracts, but shall apply international or national accounting standards addressing insurance contracts if the issuer elects in accordance with the insurance contracts standard it applies, to apply the standard on insurance contracts in recognizing and measuring them;~~

~~(e) Financial instruments that are within the scope of the international or national accounting standard on insurance~~

contracts applied by the entity because they contain a discretionary participation feature. The issuer of these instruments is exempt from applying to these features paragraphs 18 - 41 and AG24 – AG34 of this Standard regarding the distinction between financial liabilities and equity instruments. However, these instruments are subject to all other requirements of this Standard. Furthermore, this standard applies to derivatives that are embedded in these instruments (see international or national accounting standards addressing the recognition and measurement of financial instruments);

~~(e) Employers' and plans' obligations for post-employment benefits of all types, including employee benefit plans; and~~

~~(f) Financial instruments, contracts and obligations under share-based payment transactions to which international or national accounting standards addressing share-based payments applied by the entity apply, except for:~~

~~(i) Contracts within the scope of paragraphs 11 – 13 of this Standard, to which this Standards applies,~~

~~(ii) Paragraphs 42 and 43 of this Standard, which shall be applied to treasury shares purchased, sold, issued or canceled in connection with employee share option plans, employee share purchase plans, and all other share-based payment arrangements.~~

~~(g) Monetary gold;~~

~~(h) Special Drawing Rights (SDRs) in the International Monetary Fund (IMF);~~

~~(i) Currency (notes and coins) issued by the entity;~~

(g), (h) and (i)
address public
sector specific
issues not addressed
in IAS 32.

~~(j)~~ **Obligations for payments arising under social benefits provided by an entity for which it receives no consideration, or consideration that is not approximately equal to the fair value of the benefits, directly in return from the recipients of those benefits. However, entities shall apply this Standard to an interest in a controlling entity, associate or joint venture that according to IPSAS 6, IPSAS 7 or IPSAS 8 is accounted for as a financial instrument. In these cases, entities shall apply the disclosure requirements in IPSAS 6, IPSAS 7 and IPSAS 8 in addition to those in this Standard.**

5.7. This Standard does not apply to an entity's net assets/equity interests in controlled entities. However, it does apply to all financial instruments

included in the consolidated financial statements of a controlling entity, regardless of whether those instruments are held or issued by the controlling entity or by a controlled entity. Similarly, the Standard applies to financial instruments held or issued by a joint venture and included in the financial statements of a venturer either directly or through proportionate consolidation.

6.8. Some economic entities in the public sector may include entities that issue insurance contracts. Those entities are within the scope of this Standard. However, this Standard excludes the insurance contracts themselves from its scope. For the purposes of this Standard, an insurance contract is a contract that exposes the insurer to identified risks of loss from events or circumstances occurring or discovered within a specified period, including death (in the case of an annuity, the survival of the annuitant), sickness, disability, property damage, injury to others and interruption of operations. However, the provisions of this Standard apply when a financial instrument takes the form of an insurance contract but principally involves the transfer of financial risks ~~(see paragraph 49)~~, for example, some types of financial reinsurance and guaranteed investment contracts issued by public sector insurance and other entities. Entities that have obligations under insurance contracts are encouraged to consider the appropriateness of applying the provisions of this Standard in presenting ~~and disclosing~~ information about such obligations.

7.9. This Standard does not apply to financial instruments that arise from obligations from employee benefit schemes or obligations of a government to provide social benefits to its citizens for which it receives no consideration, or consideration that is not approximately equal to the fair value of the benefits, directly in return from the recipients of those benefits (such as old age pensions, unemployment benefits, disability benefits and other forms of financial assistance provided by governments).

10. Monetary gold, Special Drawing Rights in the International Monetary Fund or currency (notes and coins) issued by the entity are normally classified as financial instruments of a national government of a country and its monetary authority. These items have been excluded from the scope of this Standard but this does not preclude an entity from presenting them as financial instruments if desired.

Added re scope exclusions, explains scope exclusions.

~~8. Additional guidance on the presentation and disclosure of specific types of financial instruments can be found in international and/or national accounting standards. For example, IPSAS 13, "Leases" contains specific disclosure requirements relating to finance leases.~~

Para 8 deleted, and paras 12 – 14 inserted, as per IASB improvements project, ref. IAS 32.8 – 10.

11. This Standard shall be applied to those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements.

12. There are various ways in which a contract to buy or sell a non-financial item can be settled net in cash or another financial instrument or by exchanging financial instruments. These include:

(a) When the terms of the contract permit either party to settle it net in cash or another financial instrument or by exchanging financial instruments;

(b) When the ability to settle net in cash or another financial instrument, or by exchanging financial instruments, is not explicit in the terms of the contract, but the entity has a practice of settling similar contracts net in cash or another financial instrument, or by exchanging financial instruments (whether with the counterparty, by entering into offsetting contracts or by selling the contract before its exercise or lapse);

(c) When, for similar contracts, the entity has a practice of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a surplus from short-term fluctuations in price or dealer's margin; and

(d) When the non-financial item that is the subject of the contract is readily convertible to cash.

A contract to which (b) or (c) applies is not entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements, and, accordingly, is within the scope of this Standard. Other contracts to which paragraph 11 applies are evaluated to determine whether they were entered into and continue to be held for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirement, and accordingly, whether they are within the scope of this Standard.

13. A written option to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, in accordance with paragraph 12(a) or (d) is within the scope

of this Standard. Such a contract cannot be entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entities expected purchase, sale or usage requirements.

Definitions

9.14. The following terms are used in this Standard with the meanings specified:

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

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.

Financial asset is any asset that is:

- (a) Cash;
- (b) An equity instrument of another entity;~~A contractual right to receive cash or another financial asset from another entity;~~
- (c) A contractual right:
 - (i) To receive cash or another financial asset from another entity;
 - (ii) ~~A contractual right to~~ To exchange financial assets or liabilities instruments with another entity under conditions that are potentially favorable to the entity; or
- (d) ~~An equity instrument of another entity~~ A contract that will or may be settled in the entity's own equity instruments and is:
 - (i) A non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or
 - (ii) A derivative that will or may be settled other than by the exchange of a fixed number of the entity's own equity instruments do not include instruments that are themselves contracts for the future deliver of the entity's own equity instruments.

Amended as per IASB improvements project, ref IAS 32. 11.

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.

~~Commodity-based contracts that give either party the right to settle in cash or some other financial instrument should be accounted for as if they were financial instruments, with the exception of commodity contracts that (a) were entered into and continue to meet the entity's expected purchase, sale, or usage requirements, (b) were designated for that purpose at their inception, and (c) are expected to be settled by delivery.~~

Deleted as per IASB improvements project, ref IAS 32. 11.

Financial liability is any liability that is:

(a) - a contractual obligation:

- ~~(a)(i)~~ **To deliver cash or another financial asset to another entity; or**
- (ii) To exchange financials or financial liabilities instruments with another entity under conditions that are potentially unfavorable to the entity, or**

(b) A contract that will or may be settled in the entity's own equity instruments and is:

- (i) A non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or**
- (ii) A derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.**

Amended as per IASB improvements project, ref IAS 32. 11.

~~An entity may have a contractual obligation that it can settle either by payment of financial assets or by payment in the form of its own equity securities. In such a case, if the number of equity securities required to settle the obligation varies with changes in their fair value so that the total fair value of the equity securities paid always equals the amount of the contractual obligation, the holder of the obligation is not exposed to gain or loss from fluctuations in the price of its equity securities. Such an obligation should be accounted for as a financial liability of the entity.~~

Deleted as per IASB improvements project, ref IAS 32. 11.

Financial risk is the risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.

Amended as per IASB improvements project, ref IAS 32. 11.

An insurance contract (for the purposes of this Standard) is a contract which one party (the insurer) accepts significant risk, other than financial risk, from another party (the policy holder) by agreeing to compensate the policyholder if a specified future event adversely affects the policyholder. that exposes the insurer to identified risks of loss from events or circumstances occurring or discovered within a specified period, including death (in the case of an annuity, the survival of the annuitant), sickness, disability, property damage, injury to others and interruption of operations.

Amended as per IASB improvements project, ref IFRS 4, Appendix A. Definition no longer included in IAS 32, but is necessary for IPSAS.

Market value is the amount obtainable from the sale, or payable on the acquisition, of a financial instrument in an active market.

Monetary financial assets and financial liabilities (also referred to as monetary financial instruments) are financial assets and financial liabilities to be received or paid in fixed or determinable amounts of money.

Monetary gold is gold coins, ingots and bars with a purity of at least 995/1000 held by the monetary authority of a national government and is held as a component of the nation's official reserve assets.

Inserted by Staff to clarify the scope exclusions. The definitions are from the GFS Manual, paragraphs 7.92 & 7.95.

Special Drawing Rights (SDRs) in the International Monetary Fund are created by the International Monetary Fund (IMF) and are an unconditional right to obtain foreign currency or other reserve assets from other members of the International Monetary Fund. Special drawing rights are only held by the monetary authorities of IMF member countries and a limited number of international financial institutions.

Terms defined in other International Public Sector Accounting Standards are used in this Standard with the same meaning as in those

other Standards, and are reproduced in the Glossary of Defined Terms published separately.

~~10.15.~~ In this Standard, the terms “contract” and “contractual” refer to an agreement between two or more parties that has clear economic consequences that the parties have little, if any, discretion to avoid, usually because the agreement is enforceable at law. Contracts, and thus financial instruments, may take a variety of forms and need not be in writing.

~~11.16.~~ For purposes of the definitions in paragraph 9, the term “entity” includes public sector bodies, individuals, partnerships and incorporated bodies.

~~17. Monetary gold does not include gold held by public sector entities other than the monetary authority, except where the monetary authority is included in the consolidated financial statements of its controlling entity.~~

Inserted to clarify that not all gold is monetary gold.

~~11. Parts of the definitions of a financial asset and a financial liability include the terms financial asset and financial instrument, but the definitions are not circular. When there is a contractual right or obligation to exchange financial instruments, the instruments to be exchanged give rise to financial assets, financial liabilities, or equity instruments. A chain of contractual rights or obligations may be established but it ultimately leads to the receipt or payment of cash or to the acquisition or issuance of an equity instrument.~~

~~12. Financial instruments include both primary instruments, such as receivables, payables and equity securities, and derivative instruments, such as financial options, futures and forwards, interest rate swaps and currency swaps. Derivative financial instruments, whether recognized or unrecognized, meet the definition of a financial instrument and, accordingly, are subject to this Standard.~~

Paragraphs 11 – 20 deleted as per IASB improvements project.

~~13. Derivative financial instruments create rights and obligations that have the effect of transferring between the parties to the instrument one or more of the financial risks inherent in an underlying primary financial instrument. Derivative instruments do not result in a transfer of the underlying primary financial instrument on inception of the contract and such a transfer does not necessarily take place on maturity of the contract.~~

~~14. Physical assets such as inventories, property, plant and equipment, leased assets and intangible assets such as radio spectrum, patents and trademarks are not financial assets. Control of such physical and intangible assets creates an~~

opportunity to generate an inflow of cash or other assets but it does not give rise to a present right to receive cash or other financial assets.

15. Assets, such as prepaid expenses, 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 deferred revenue and most warranty obligations are not financial liabilities because the probable outflow of economic benefits associated with them is the delivery of goods and services rather than cash or another financial asset.

16. Liabilities or assets that are not contractual in nature, such as income taxes or tax equivalents that are created as a result of statutory requirements imposed on public sector entities by governments, are not financial liabilities or financial assets. International Accounting Standard (IAS) 12, “Income Taxes” provides guidance on accounting for income taxes.

17. Contractual rights and obligations that do not involve the transfer of a financial asset do not fall within the scope of the definition of a financial instrument. For example, some contractual rights (obligations), such as those that arise under a commodity futures contract, can be settled only by the receipt (delivery) of non-financial assets. Similarly, contractual rights (obligations) such as those that arise under an operating lease or build-own-operate arrangement for use of a physical asset, such as a hospital, can be settled only by the receipt (delivery) of services. In both cases, the contractual right of one party to receive a non-financial asset or service and the corresponding obligation of the other party do not establish a present right or obligation of either party to receive, deliver or exchange a financial asset. (Refer to Appendix 2, paragraphs A13–A17.)

18. The ability to exercise a contractual right or the requirement to satisfy a contractual obligation may be absolute, or it may be contingent on the occurrence of a future event. For example, a financial guarantee is a contractual right of the lender to receive cash from the guarantor, and a corresponding contractual obligation of the guarantor to pay the lender, if the borrower defaults. The contractual right and obligation exist because of a past transaction or event (assumption of the guarantee), even though the lender’s ability to exercise its right and the requirement for the guarantor to perform under its obligation are both contingent on a future act of default by the borrower. A contingent right and obligation meet the definition of a financial asset and a financial liability, even though many such assets and liabilities do not qualify for recognition in financial statements. For example, a national government may provide a private sector operator of an infrastructure facility protection against demand risk by guaranteeing a minimum level of revenue. The guarantee is a contingent obligation of the

~~government until it becomes probable that the operator's revenue will fall below the guaranteed minimum.~~

~~19. An obligation of an entity to issue or deliver its own equity instruments, such as a share option or warrant, is itself an equity instrument, not a financial liability, since the entity is not obliged to deliver cash or another financial asset. Similarly, the cost incurred by an entity to purchase a right to reacquire its own equity instruments from another party is a deduction from its net assets/equity, not a financial asset.~~

~~20. The minority interest that may arise on an entity's statement of financial position from consolidating a controlled entity is not a financial liability or an equity instrument of the entity. In consolidated financial statements, an entity presents the interests of other parties in the net assets/equity and the net surplus or deficit of its controlled entities in accordance with IPSAS 6. Accordingly, a financial instrument classified as an equity instrument by a controlled entity is eliminated on consolidation when held by the controlling entity, or presented by the controlling entity in the consolidated statement of financial position as a minority interest separate from the net assets/equity of its own shareholders. A financial instrument classified as a financial liability by a controlled entity remains a liability in the controlling entity's consolidated statement of financial position unless eliminated on consolidation as an intra-economic entity balance. The accounting treatment by the controlling entity on consolidation does not affect the basis of presentation by the controlled entity in its financial statements.~~

Presentation

Liabilities and Net assets/Equity (see also paragraph AG24 to AG28)

22.18. The issuer of a financial instrument ~~should~~ shall classify the instrument, or its component parts, on initial recognition as a financial liability, financial asset or as an net assets/equity instrument in accordance with the substance of the contractual arrangement ~~on initial recognition~~ and the definitions of a financial liability and an equity instrument.

Amended as per IASB improvements project, ref IAS 32. 15.

19. When an issuer applies the definitions in paragraph 14 to determine whether a financial instrument is an equity instrument rather than a financial liability, the instrument is an equity instrument if, and only if, both conditions (a) and (b) below are met.

(a) The instrument includes no contractual obligation:

- (i) To deliver cash or another financial asset to another entity; or
- (ii) To exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the issuer.

Paragraphs 20 – 21 inserted as per IASB improvements project, ref IAS 32.16 – 17.

(b) If the instrument will or may be settled in the issuer's own equity instruments, it is:

- (i) A non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or
- (ii) A derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose the issuer's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the issuer's own equity instruments.

A contractual obligation, including one arising from a derivative financial instrument, that will or may result in the future receipt or delivery of the issuer's own equity instruments, but does not meet conditions (a) and (b) above, is not an equity instrument

No contractual obligation to deliver cash or another financial asset (see paragraph 19(a))

20. A critical feature in differentiating a financial liability from an equity instrument is the existence of a contractual obligation of one party to the financial instrument (the issuer) either to deliver cash or another financial asset to the other party (the holder) or to exchange another financial instrument with the holder under conditions that are potentially unfavorable to the issuer. Although the holder of an equity instrument may be entitled to receive a pro rata share of any dividends, or similar distributions, or other distributions of the entity, the issuer does not have a contractual obligation to make such distributions because it cannot be required to deliver cash or another financial asset to another party.

21. The substance of a financial instrument, rather than its legal form, governs its classification on the issuer's statement of financial position. While substance and legal form are commonly consistent, this is not always the case. For example, some financial instruments take the legal form of equity but are liabilities in substance and others may combine features associated with equity instruments and features associated with financial liabilities.

(a) A preference share that provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date, or gives the holder the right to require the issuer to redeem the instrument at or after a particular date for a fixed or determinable amount, is a financial liability.

Amended as per
IASB
improvements
project, ref IAS
32. 18.

(b) A financial instrument that gives the holder the right to put it back to the issuer for cash or another financial asset (a 'puttable instrument') is a financial liability. This is so even when the amount of cash or other financial assets is determined on the basis of an index or other item that has the potential to increase or decrease, or when the legal form of the puttable instrument gives the holder a right to a residual interest in the assets of an issuer. The existence of an option for the holder to put the instrument back to the issuer for cash or another financial asset means that the puttable instrument meets the definition of a financial liability. For example, open-ended mutual funds, unit trusts, partnerships and some co-operative entities may provide their unitholders or members with a right to redeem their interests in the issuer at any time for cash equal to their proportionate share of the asset value of the issuer. However, classification as a financial liability does not preclude the use of descriptors such as 'net asset value attributable to unitholders' and

‘change in net asset value attributable to unitholders’ on the face of the financial statements of an entity that has no contributed net assets (such as some mutual funds and unit trusts, see Illustrative Example 7) or the use of additional disclosure to show that total members’ interests comprise items such as reserves that meet the definition of net assets and puttable instruments that do not (see Illustrative Example 8).

The classification of an instrument is made on the basis of an assessment of its substance when it is first recognized. That classification continues at each subsequent reporting date until the financial instrument is removed from the entity’s statement of financial position. The ~~classification of financial instruments as either liabilities or net assets/equity~~ reclassification of financial instruments as either liabilities or net assets/equity is not likely to be a significant issue for many reporting entities in the public sector.

22. If an entity does not have an unconditional right to avoid delivering cash or another financial asset to settle a contractual obligation, the obligation meets the definition of a financial liability. For example:

Inserted as per IASB improvements project, ref IAS 32. 19.

(a) A restriction on the ability of an entity to satisfy a contractual obligation, such as lack of access to foreign currency or the need to obtain approval for payment from a regulatory authority, does not negate the entity’s contractual obligation or the holder’s contractual right under the instrument.

(b) A contractual obligation that is conditional on a counterparty exercising its right to redeem is a financial liability because the entity does not have the unconditional right to avoid delivering cash or another financial asset.

22.23. Classification of financial instruments between liabilities and net assets/equity components is required because of the different risks associated with each. Entities with instruments classified as financial liabilities are required to ~~disclose information on interest rate risk exposure in accordance with paragraph 63, and to~~ recognize interest, dividends, or similar distributions, losses or gains as revenue or expense in accordance with paragraph 44~~36~~. Paragraph 44~~36~~ also specifies that distributions to holders of financial instruments classified as equity instruments should be debited by the issuer directly to net assets/equity.

Amended as per IASB improvements project, ref IAS 32. 20. “Similar distributions is a public sector specific amendment.

24. While public sector entities will often hold an equity instrument as an investment (financial assets) it is not common for a public sector entity to issue equity instruments to parties outside the economic entity except where a controlled entity is partly-privatized. Nevertheless, the use of financial instruments in the public sector continues to evolve and classification by the issuer needs to be guided by their substance and not necessarily their form.
25. The critical feature in differentiating a financial liability from an equity instrument is the existence of a contractual obligation on one party to the financial instrument (the issuer) either to deliver cash or another financial asset to the other party (the holder) or to exchange another financial instrument with the holder under conditions that are potentially unfavorable to the issuer. When such a contractual obligation exists, that instrument meets the definition of a financial liability regardless of the manner in which the contractual obligation will be settled. A restriction on the ability of the issuer to satisfy an obligation, such as lack of access to foreign currency or the need to obtain approval for payment from a regulatory authority, does not negate the issuer's obligation or the holder's right under the instrument.
26. When a financial instrument does not give rise to a contractual obligation on the part of the issuer to deliver cash or another financial asset or to exchange another financial instrument under conditions that are potentially unfavorable, it is an equity instrument. Although the holder of an equity instrument may be entitled to receive a pro rata share of any dividends or ~~other~~ similar distributions out of net assets/equity, the issuer does not have a contractual obligation to make such distributions.
27. A public sector entity may issue instruments with particular rights, such as ~~preferred-preference~~ shares. When a ~~preferred-preference~~ share provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date or gives the holder the right to require the issuer to redeem the share at or after a particular date for a fixed or determinable amount, the instrument meets the definition of a financial liability and is classified as such. A ~~preferred-preference~~ share that does not establish such a contractual obligation explicitly may establish it indirectly through its terms and conditions. For example, a ~~preferred~~ preference share that does not provide for mandatory redemption or redemption at the option of the holder may have a contractually provided accelerating dividend or similar distribution such that, within the

Amended as per IPSASB improvements project, "dividends or similar distributions" is now standard text..

Amended as per IASB improvements project, ref IAS 32. 18(a), change of terminology to "preference share". Inclusion of "similar distributions" as per IPSASB standard terminology.

foreseeable future, the dividend or similar distribution yield is scheduled to be so high that the issuer will be economically compelled to redeem the instrument. In these circumstances, classification as a financial liability is appropriate because the issuer has little, if any, discretion to avoid redeeming the instrument. Similarly, if a financial instrument labeled as a share gives the holder an option to require redemption upon the occurrence of a future event that is highly likely to occur, classification as a financial liability on initial recognition reflects the substance of the instrument. (Refer to Appendix 2, paragraphs AG6, ~~AG13A7~~–AG14A8 and AG24A18–AG25A21.)

28. A financial instrument that does not explicitly establish a contractual obligation to deliver cash or another financial asset may establish an obligation indirectly through its terms and conditions. For example:

Paragraphs 29 – 36
inserted as per IASB
improvements project,
ref IAS 32. 20 – 27.

- (a) A financial instrument may contain a non-financial obligation that must be settled if, and only if, the entity fails to make distributions or to redeem the instrument. If the entity can avoid a transfer of cash or another financial asset only by settling the non-financial obligation, the financial instrument is a financial liability.
- (b) A financial instrument is a financial liability if it provides that on settlement the entity will deliver either:
 - (i) Cash or another financial asset; or
 - (ii) Its own shares whose value is determined to exceed substantially the value of the cash or other financial asset.

Settlement in the entity's own equity instruments (paragraph 19(b))

29. A contract is not an equity instrument solely because it may result in the receipt or delivery of the entity's own equity instruments. An entity may have a contractual right or obligation to receive or deliver a number of its own shares or other equity instruments that varies so that the fair value of the entity's own equity instruments to be received or delivered equals the amount of the contractual right or obligation. Such a contractual right or obligation may be for a fixed amount or an amount that fluctuates in part or in full in response to changes in a variable other than the market price of the entity's own equity instruments (e.g. an interest rate, a commodity price or a financial instrument price). Two examples are (a) a contract to deliver as

many of the entity's own equity instruments as are equal in value to CU100,* and (b) a contract to deliver as many of the entity's own equity instruments as are equal in value to the value of 100 ounces of gold. Such a contract is a financial liability of the entity even though the entity must or can settle it by delivering its own equity instruments. It is not an equity instrument because the entity uses a variable number of its own equity instruments as a means to settle the contract. Accordingly, the contract does not evidence a residual interest in the entity's assets after deducting all of its liabilities.

30. A contract that will be settled by the entity (receiving or) delivering a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument. For example, an issued share option that gives the counterparty a right to buy a fixed number of the entity's shares for a fixed price or for a fixed stated principal amount of a bond is an equity instrument. Changes in the fair value of a contract arising from variations in market interest rates that do not affect the amount of cash or other financial assets to be paid or received, or the number of equity instruments to be received or delivered, on settlement of the contract do not preclude the contract from being an equity instrument. Any consideration received (such as the premium received for a written option or warrant on the entity's own shares) is added directly to net assets. Any consideration paid (such as the premium paid for a purchased option) is deducted directly from net assets. Changes in the fair value of an equity instrument are not recognized in the financial statements.

31. A contract that contains an obligation for an entity to purchase its own equity instruments for cash or another financial asset gives rise to a financial liability for the present value of the redemption amount (for example, for the present value of the forward repurchase price, option exercise price or other redemption amount). This is the case even if the contract itself is an equity instrument. One example is an entity's obligation under a forward contract to purchase its own equity instruments for cash. When the financial liability is recognized initially under the international or national standard addressing recognition and measurement of financial instruments applied by the entity, its fair value (the present value of the redemption amount) is reclassified from net assets. Subsequently, the financial liability is measured in accordance with international or national accounting standard addressing recognition and measurement of financial instruments. If the contract expires without delivery, the carrying amount of the financial liability is reclassified to net assets. An entity's contractual obligation to purchase its own equity instruments gives rise to a financial

* In this Standard, monetary amounts are denominated in 'currency units' (CU).

liability for the present value of the redemption amount even if the obligation to purchase is conditional on the counterparty exercising a right to redeem (e.g. a written put option that gives the counterparty the right to sell an entity's own equity instruments to the entity for a fixed price).

32. A contract that will be settled by the entity delivering or receiving a fixed number of its own equity instruments in exchange for a variable amount of cash or another financial asset is a financial asset or financial liability. An example is a contract for the entity to deliver 100 of its own equity instruments in return for an amount of cash calculated to equal the value of 100 ounces of gold.

Contingent settlement provisions

33. A financial instrument may require the entity to deliver cash or another financial asset, or otherwise to settle it in such a way that it would be a financial liability, in the event of the occurrence or non-occurrence of uncertain future events (or on the outcome of uncertain circumstances) that are beyond the control of both the issuer and the holder of the instrument, such as a change in a stock market index, consumer price index, interest rate or taxation requirements, or the issuer's future revenues, net income or debt-to-net assets ratio. The issuer of such an instrument does not have the unconditional right to avoid delivering cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability). Therefore, it is a financial liability of the issuer unless:

- (a) The part of the contingent settlement provision that could require settlement in cash or another financial asset (or otherwise in such a way that it would be a financial liability) is not genuine; or
- (b) The issuer can be required to settle the obligation in cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability) only in the event of liquidation of the issuer.

Settlement Options

34. When a derivative financial instrument gives one party a choice over how it is settled (e.g. the issuer or the holder can choose settlement net in cash or by exchanging shares for cash), it is a financial asset or a financial liability unless all of the settlement alternatives would result in it being an equity instrument.
35. An example of a derivative financial instrument with a settlement option that is a financial liability is a share option that the issuer can decide to settle net in cash or by exchanging its own shares for cash. Similarly, some

contracts to buy or sell a non-financial item in exchange for the entity's own equity instruments are within the scope of this Standard because they can be settled either by delivery of the non-financial item or net in cash or another financial instrument (see paragraphs 11 to 13). Such contracts are financial assets or financial liabilities and not equity instruments.

Classification of Compound financial Instruments~~instruments~~ **by the Issuer**~~(see also paragraphs AG29 – AG34 and illustrative examples 9 – 12)~~

~~29.36.~~ The issuer of a **non-derivative financial instrument shall evaluate the terms of the financial instrument to determine whether it that contains both a liability and a net assets/equity element component. should Such components shall be classify—classified the instrument's component parts separately as financial liabilities, financial assets or equity instruments in accordance with paragraph 1822.**

Amended as per IASB improvements project, ref IAS 32. 28.

~~30.37.~~ Public sector entities do not commonly issue compound financial instruments. The exceptions include partly-privatized GBEs within an economic entity that issues compound instruments into the financial markets. Where a public sector entity issues a compound instrument, this Standard requires the separate presentation on an issuer's statement of financial position of liability and net assets/equity elements created by a single financial instrument. It is more a matter of form than substance that both liabilities and net assets/equity interests are created by a single financial instrument rather than two or more separate instruments. An issuer's financial position is more faithfully represented by separate presentation of liability and net assets/equity components contained in a single instrument according to their nature. ~~(Refer to Appendix 2, paragraphs A22–A23.)~~

Amended as per IASB improvements project, references to the Application Guidance are now in section headings.

~~31.38.~~ ~~For purposes of statement of financial position presentation, a~~An issuer recognizes separately the components ~~s parts~~ of a financial instrument that ~~(a)~~ creates a **primary** financial liability of the **issuer entity** and ~~(b)~~ grants an option to the holder of the instrument to convert it into an equity instrument of the **issuer entity**. ~~For example, A a bond or similar instrument convertible by the holder into a fixed number of ordinary common shares of the issuer entity is an example of such an a compound financial instrument. From the perspective of the issuer entity, such an instrument comprises two components: a financial liability (a contractual arrangement to deliver cash or other financial assets)~~

Amended as per IASB improvements project, ref IAS 32. 29.

and an equity instrument (a call option granting the holder the right, for a specified period of time, to convert into a fixed number of common ordinary shares of the issuer entity). The economic effect of issuing such an instrument is substantially the same as issuing simultaneously a debt instrument with an early settlement provision and warrants to purchase common ordinary shares, or issuing a debt instrument with detachable share purchase warrants. Accordingly, in all cases, the issuer entity presents the liability and net assets/equity elements separately on its statement of financial position.

32.39. Classification of the liability and net assets/equity components of a convertible instrument is not revised as a result of a change in the likelihood that a conversion option will be exercised, even when exercise of the option may appear to have become economically advantageous to some holders. Holders may not always act in the manner that might be expected because, for example, the tax consequences (where applicable) resulting from conversion may differ among holders. Furthermore, the likelihood of conversion will change from time to time. The issuer's entity's contractual obligation to make future payments remains outstanding until it is extinguished through conversion, the maturity of the instrument or some other transaction.

Amended as per
IASB
improvements
project, ref IAS
32. 30.

40. International and national accounting standards on the recognition and measurement of financial instruments deal with the measurement of financial assets and financial liabilities. Equity instruments are instruments that evidence a residual interest in the assets of an entity after deducting all of its liabilities. Therefore, when the initial carrying amount of a compound financial instrument is allocated to its net assets and liability components, the net assets component is assigned the residual amount after deducting from the fair value of the instrument as a whole the amount separately determined for the liability component. The value of any derivative features (such as a call option) embedded in the compound financial instrument other than the net assets component (such as a net assets conversion option) is included in the liability component. The sum of the carrying amounts assigned to the liability and net assets components on initial recognition is always equal to the fair value that would be ascribed to the instrument as a whole. No gain or loss arises from initially recognizing the components of the instrument separately.

Inserted as per
IASB
improvements
project, ref IAS
32. 31.

~~22.A financial instrument may contain components that are neither financial liabilities nor equity instruments of the issuer. For example, an instrument~~

~~may give the holder the right to receive a non-financial asset such as a right to operate a government-owned monopoly or a commodity in settlement and an option to exchange that right for shares of the issuer. The issuer recognizes and presents the equity instrument (the exchange option) separately from the liability components of the compound instrument, whether the liabilities are financial or non-financial.~~

Paragraphs 22 –
23 deleted as per
IASB
improvements
project.

~~23. This Standard does not deal with measurement of financial assets, financial liabilities and equity instruments and does not therefore prescribe any particular method for assigning a carrying amount to liability and net assets/equity elements contained in a single instrument. Approaches that might be followed include:~~

- ~~(a) Assigning to the less easily measurable component (often an equity instrument), the residual amount after deducting from the instrument as a whole the amount separately determined for the component that is more easily measurable; and~~
- ~~(b) Measuring the liability and net assets/equity components separately and, to the extent necessary, adjusting these amounts on a pro-rata basis so that the sum of the components equals the amount of the instrument as a whole.~~

~~The sum of the carrying amounts assigned to the liability and net assets/equity components on initial recognition is always equal to the carrying amount that would be ascribed to the instrument as a whole. No gain or loss arises from recognizing and presenting the components of the instrument separately.~~

35.41. ~~Under the first approach described in paragraph 4034, where, for example, a public sector entity issues the issuers of a bond convertible into an equity interest it first determines the carrying amount of the financial liability by discounting the stream of future payments of interest and principal at the prevailing market rate for measuring the fair value of a similar liability (including any embedded non-net assets/equity derivative features) that does not have an associated net assets/equity component. The carrying amount of the equity instrument represented by the option to convert the instrument into common-ordinary shares may-is then be determined by deducting the carrying amount-fair value of the financial liability from the amount-fair value of the compound financial instrument as a whole. Under the second approach, the issuer determines the value of the option directly either by reference to the fair value of a similar option, if one exists, or by using an option-pricing model. The value determined for each component is then~~

Amended as per
IASB
improvements
project, ref IAS
32. 32.

~~adjusted on a pro-rata basis to the extent necessary to ensure that the sum of the carrying amounts assigned to the components equals the amount of the consideration received for the convertible bond. (Refer to Appendix 2, paragraph A24.)~~

Treasury shares (see also paragraph AG35)

42. If an entity reacquires its own equity instruments, those instruments ('treasury shares') shall be deducted from net assets. No gain or loss shall be recognized in surplus or deficit on the purchase, sale, issue or cancellation of an entity's own equity instruments. Such treasury shares may be acquired and held by the entity or by other members of the consolidated economic entity. Consideration paid or received shall be recognized directly in net assets.

Paragraphs 43 –
44 inserted as per
IASB
improvements
project, ref IAS
32. 33 – 34.

43. The amount of treasury shares held is disclosed separately either on the face of the statement of financial position or in the notes, in accordance with the IPSAS 1, "Presentation of Financial Statements." An entity provides disclosure in accordance with the IPSAS 20 "Related Party Disclosures" if the entity reacquires its own equity instruments from related parties.

Interest, ~~Dividends~~ dividends or similar distributions, ~~Losses~~ losses and Gains (see also paragraph AG36)

36.44. Interest, dividends or similar distributions, losses and gains relating to a financial instrument, or a ~~component part, classified as component that is~~ a financial liability ~~should~~ shall be reported ~~recognized in the statement of financial performance~~ as expense or revenue in surplus or deficit. Distributions to holders of ~~a financial instrument classified as an equity instrument~~ ~~should~~ shall be debited by the ~~issuer entity~~ directly to net assets/equity net of any related income tax benefit (where applicable). Transaction costs of a net assets/equity transaction shall be accounted for as a deduction from net assets, net of any related income tax benefit (where applicable).

Amended as per
IASB
improvements
project, ref IAS
32. 35.

37.45. The classification of a financial instrument ~~as a financial liability or an equity instrument in the statement of financial position~~ determines whether interest, dividends or similar distributions, losses and gains relating to that instrument are ~~classified~~ recognized as ~~expenses or revenue~~ or expense in surplus or deficit and reported in

Amended as per
IASB
improvements
project, ref IAS
32.36.

~~the statement of financial performance.~~ Thus, dividend or similar distribution payments on shares wholly recognized ~~classified~~ as liabilities are ~~classified~~ recognized as expenses in the same way as interest on a bond ~~and reported in the statement of financial performance.~~ Similarly, gains and losses associated with redemptions or ~~refinancings~~ refinancings of financial liabilities instruments ~~classified~~ are recognized in surplus or deficit ~~as liabilities are reported in the statement of financial performance, while~~ whereas redemptions or refinancings of equity instruments ~~classified as net assets/equity of the issuer are reported~~ recognized as movements ~~changes~~ in net assets/equity. Changes in the fair value of an equity instrument are not recognized in the financial statements.

46. An entity typically incurs various costs in issuing or acquiring its own equity instruments. Those costs might include registration and other regulatory fees, amounts paid to legal, accounting and other professional advisers, printing costs and stamp duties. The transaction costs of a net assets transaction are accounted for as a deduction from net assets (net of any related income tax benefit (where applicable)) to the extent they are incremental costs directly attributable to the net assets transaction that otherwise would have been avoided. The costs of a net assets transaction that is abandoned are recognized as an expense.

Paragraphs 47 –
49 inserted as per
IASB
improvements
project, ref IAS
32, 37 - 39.

47. Transaction costs that relate to the issue of a compound financial instrument are allocated to the liability and net assets components of the instrument in proportion to the allocation of proceeds. Transaction costs that relate jointly to more than one transaction (for example, costs of a concurrent offering of some shares and a stock exchange listing of other shares) are allocated to those transactions using a basis of allocation that is rational and consistent with similar transactions.

48. The amount of transaction costs accounted for as a deduction from net assets in the period is disclosed separately under IPSAS 1, "Presentation of Financial Statements." The related amount of income taxes (where applicable) recognized directly in net assets is included in the aggregate amount of current and deferred income tax (where applicable) credited or charged to net assets that is disclosed under any international or national accounting standard addressing income taxes that is applied by the entity.

~~38-49.~~ Dividends or similar distributions classified as an expense may be presented in the statement of financial performance either with interest on other liabilities or as a separate item. In addition to the requirements of this standard, disclosure of interest and dividends or similar distributions is subject to the requirements of IPSAS 1, "Presentation of Financial

Statements.” Disclosure of the tax effects (where applicable) are made in accordance with any international or national accounting standard addressing income taxes payable that is applied by the entity.~~Disclosure of interest and dividends is subject to the requirements of IPSAS 1, “Presentation of Financial Statements.” In some circumstances, because of significant differences between interest and dividends with respect to matters such as tax deductibility, it is desirable to disclose them separately within the statement of financial performance. For entities subject to income taxes, guidance on the disclosure of the amounts of tax effects can be found in IAS 12.~~

Amended as per IASB improvements project and IPSASB’s standard terminology, ref IAS 32. 40.

50. Gains and losses related to changes in the carrying amount of a financial liability are recognized as revenue or expense in surplus or deficit even when they relate to an instrument that includes a right to the residual interest in the assets of the entity in exchange for cash or another financial asset (see paragraph 21(b)). Under IPSAS 1, “Presentation of Financial Statements” the entity presents any gain or loss arising from remeasurement of such an instrument separately on the face of the Statement of Financial Performance when it is relevant in explaining the entity’s performance.

Inserted as per IASB improvements project, ref IAS 32. 41.

Offsetting of a ~~Financial financial Asset asset~~ and a ~~Financial financial Liability liability~~ (see also paragraphs AG37 and AG38)

39.51. A financial asset and a financial liability ~~should shall~~ be offset and the net amount ~~reported presented~~ in the statement of financial position when, and only when, an entity:

- (a) Has a legally enforceable right to set off the recognized amounts; and
- (b) Intends either to settle on a net basis, or to realize the asset and settle the liability simultaneously.

Amended as per IASB improvements project, ref IAS 32. 42.

In accounting for a transfer of a financial asset that does not qualify for derecognition, the entity shall not offset the transferred asset and the associated liability (derecognition of financial instruments is addressed in international and national standards dealing with the recognition and measurement of financial instruments).

40.52. This Standard requires the presentation of financial assets and financial liabilities on a net basis when ~~this doing so~~ reflects an entity’s expected

future cash flows from settling two or more separate financial instruments. When an entity has the right to receive or pay a single net amount and intends to do so, it has, in effect, only a single financial asset or financial liability. For example, a state government settles a financial liability to a national government on a net basis (that is, after deducting a financial asset it was owed by the national government). In other circumstances, financial assets and financial liabilities are presented separately from each other consistent with their characteristics as ~~assets-resources~~ or ~~liabilities-obligations~~ of the entity. ~~(Refer to Appendix 2, paragraph A25.)~~

Amended as per IASB improvements project, ref IAS 32. 43.

~~41-53.~~ Offsetting a recognized financial asset and a recognized financial liability and presenting the net amount differs from ~~ceasing to recognize~~ the derecognition of a financial asset or a financial liability. While offsetting does not give rise to recognition of a gain or a loss, ~~ceasing to recognize the derocognition of~~ a financial instrument not only results in the removal of the previously recognized item from the statement of financial position but may also result in recognition of a gain or a loss.

Amended as per IASB improvements project, ref IAS 32. 44.

~~42-54.~~ A right of set-off is a debtor's legal right, by contract or otherwise, to settle or otherwise eliminate all or a portion of an amount due to a creditor by applying against that amount an amount due from the creditor. In unusual circumstances, a debtor may have a legal right to apply an amount due from a third party against the amount due to a creditor provided that there is an agreement among the three parties that clearly establishes the debtor's right of set-off. ~~Since~~ Because the right of set-off is a legal right, the conditions supporting the right may vary from one legal jurisdiction to another and ~~care must be taken to establish which the laws apply applicable~~ to the relationships between the parties need to be considered.

Amended as per IASB improvements project, ref IAS 32. 45.

~~43-55.~~ The existence of an enforceable right to set off a financial asset and a financial liability affects the rights and obligations associated with a financial asset and a financial liability and may affect significantly an entity's exposure to credit and liquidity risk. However, the existence of the right, by itself, is not a sufficient basis for offsetting. In the absence of an intention to exercise the right or to settle simultaneously, the amount and timing of an entity's future cash flows are not affected. When an entity does intend to exercise the right or to settle simultaneously, presentation of the asset and liability on a net basis reflects more appropriately the amounts and timing of the expected future cash flows, as well as the risks to which those

cash flows are exposed. An intention by one or both parties to settle on a net basis without the legal right to do so is not sufficient to justify offsetting ~~since~~because the rights and obligations associated with the individual financial asset and financial liability remain unaltered.

Amended as per IASB improvements project, ref IAS 32. 46.

44.56. An entity's intentions with respect to settlement of particular assets and liabilities may be influenced by its normal operating practices, the requirements of the financial markets and other circumstances that may limit the ability to settle net or to settle simultaneously. When an entity has a right of set-off but does not intend to settle net or to realize the asset and settle the liability simultaneously, the effect of the right on the entity's credit risk exposure is disclosed in accordance with ~~the standard in paragraph 73~~any international or national accounting standard addressing disclosure of financial instruments applied by the entity.

Amended as per IASB improvements project, ref IAS 32. 47.

45.57. Simultaneous settlement of two financial instruments may occur through, for example, the operation of a clearing house in an organized financial market or a face-to-face exchange. In these circumstances the cash flows are, in effect, equivalent to a single net amount and there is no exposure to credit or liquidity risk. In other circumstances, an entity may settle two instruments by receiving and paying separate amounts, becoming exposed to credit risk for the full amount of the asset or liquidity risk for the full amount of the liability. Such risk exposures may be significant even though relatively brief. Accordingly, realization of a financial asset and settlement of a financial liability are considered simultaneous only when the transactions occur at the same moment.

46.58. The conditions set out in paragraph 51~~39~~ are generally not satisfied and offsetting is usually inappropriate when:

- (a) Several different financial instruments are used to emulate the features of a single financial instrument (~~that is, a~~ "synthetic instrument");
- (b) Financial assets and financial liabilities arise from financial instruments having the same primary risk exposure (for example, assets and liabilities within a portfolio of forward contracts or other derivative instruments) but involve different counterparties;
- (c) Financial or other assets are pledged as collateral for non-recourse financial liabilities;
- (d) Financial assets are set aside in trust by a debtor for the purpose of discharging an obligation without those assets having been accepted

Amended as per IASB improvements project, ref IAS 32. 49.

by the creditor in settlement of the obligation (for example, a sinking fund arrangement); or

- (e) Obligations incurred as a result of events giving rise to losses are expected to be recovered from a third party by virtue of a claim made under an insurance ~~policy~~contract.

~~47.59.~~ An entity that undertakes a number of financial instrument transactions with a single counterparty may enter into a “master netting arrangement” with that counterparty. Such an agreement provides for a single net settlement of all financial instruments covered by the agreement in the event of default on, or termination of, any one contract. These arrangements are commonly used by financial institutions to provide protection against loss in the event of bankruptcy or other events that result in a counterparty being unable to meet its obligations. A master netting arrangement commonly creates a right of set-off that becomes enforceable and affects the realization or settlement of individual financial assets and financial liabilities only following a specified event of default or in other circumstances not expected to arise in the normal course of operations. A master netting arrangement does not provide a basis for offsetting unless both of the criteria in paragraph 51~~39~~ are satisfied. ~~When financial assets and financial liabilities subject to a master netting arrangement are not offset, the effect of the arrangement on an entity’s exposure to credit risk is disclosed in accordance with paragraph 73.~~

Amended as per IASB improvements project, ref IAS 32. 50.

Disclosure

~~37. The purpose of the disclosures required by this Standard is to provide information that will enhance understanding of the significance of on balance sheet and off balance sheet financial instruments to an entity’s financial position, performance and cash flows and assist in assessing the amounts, timing and certainty of future cash flows associated with those instruments. In addition to providing specific information about particular financial instrument balances and transactions, entities are encouraged to provide a discussion of the extent to which financial instruments are used, the associated risks and the financial purposes served. A discussion of management’s policies for controlling the risks associated with financial instruments, including policies on matters such as hedging of risk exposures, avoidance of undue concentrations of risk and requirements for collateral to mitigate credit risks, provides a valuable additional perspective that is independent of the specific instruments outstanding at a particular time. Some entities provide~~

Paragraphs 37 – 90 deleted as per IASB improvements project, ref IFRS 7.

~~such information in a commentary that accompanies their financial statements rather than as part of the financial statements.~~

~~38. Transactions in financial instruments may result in an entity assuming or transferring to another party one or more of the financial risks described below. The required disclosures provide information that assists users of financial statements in assessing the extent of risk related to both recognized and unrecognized financial instruments.~~

~~(a) Price risk—There are three types of price risk: currency risk, interest rate risk and market risk.~~

~~(i) Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates.~~

~~(ii) Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates.~~

~~(iii) Market risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices whether those changes are caused by factors specific to the individual security or its issuer or factors affecting all securities traded in the market.~~

~~The term “price risk” embodies not only the potential for loss but also the potential for gain.~~

~~(b) Credit risk—Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.~~

~~(c) Liquidity risk—Liquidity risk, also referred to as funding risk, is the risk that an entity will encounter difficulty in raising funds to meet commitments associated with financial instruments. Liquidity risk may result from an inability to sell a financial asset quickly at close to its fair value. For some public sector entities, such as a national government, liquidity risks may be mitigated by raising taxes or other charges levied by the entity.~~

~~(d) Cash flow risk—Cash flow risk is the risk that future cash flows associated with a monetary financial instrument will fluctuate in amount. In the case of a floating rate debt instrument, for example, such fluctuations result in a change in the effective interest rate of the financial instrument, usually without a corresponding change in its fair value.~~

Disclosure of Risk Management Policies

~~39. An entity should describe its financial risk management objectives and policies, including its policy for hedging each major type of forecasted transaction for which hedge accounting is used.~~

~~40. The standards do not prescribe either the format of the information required to be disclosed or its location within the financial statements. With regard to recognized financial instruments, to the extent that the required information is presented on the face of the statement of financial position, it is not necessary for it to be repeated in the notes to the financial statements. With regard to unrecognized financial instruments, however, information in notes or supplementary schedules is the primary means of disclosure. Disclosures may include a combination of narrative descriptions and specific quantified data, as appropriate to the nature of the instruments and their relative significance to the entity.~~

~~41. Determination of the level of detail to be disclosed about particular financial instruments is a matter for the exercise of judgment taking into account the relative significance of those instruments. It is necessary to strike a balance between overburdening financial statements with excessive detail that may not assist users of financial statements and obscuring significant information as a result of too much aggregation. For example, when an entity is party to large numbers of financial instruments with similar characteristics and no one contract is individually significant, summarized information by reference to particular classes of instruments is appropriate. On the other hand, specific information about an individual instrument may be important when that instrument represents, for example, a significant element in an entity's capital structure.~~

~~42. Management of an entity group's financial instruments into classes that are appropriate to the nature of the information to be disclosed, taking into account matters such as the characteristics of the instruments, whether they are recognized or unrecognized and, if they are recognized, the measurement basis that has been applied. In general, classes are determined on a basis that distinguishes items carried on a cost basis from items carried at fair value. When amounts disclosed in notes or supplementary schedules relate to recognized assets and liabilities, sufficient information is provided to permit a reconciliation to relevant line items on the statement of financial position. When an entity is a party to financial instruments not dealt with by this Standard, such as obligations under retirement benefit plans or insurance contracts, these instruments constitute a class or classes of financial assets or financial liabilities disclosed separately from those dealt with by this Standard.~~

Terms, Conditions and Accounting Policies

~~43. For each class of financial asset, financial liability and equity instrument, both recognized and unrecognized, an entity should disclose:~~

- ~~(a) Information about the extent and nature of the financial instruments, including significant terms and conditions that may affect the amount, timing and certainty of future cash flows; and~~
- ~~(b) The accounting policies and methods adopted, including the criteria for recognition and the basis of measurement applied.~~

~~44. The contractual terms and conditions of a financial instrument are an important factor affecting the amount, timing and certainty of future cash receipts and payments by the parties to the instrument. When recognized and unrecognized instruments are important, either individually or as a class, in relation to the current financial position of an entity or its future operating results, their terms and conditions are disclosed. If no single instrument is individually significant to the future cash flows of a particular entity, the essential characteristics of the instruments are described by reference to appropriate groupings of like instruments.~~

~~45. When financial instruments held or issued by an entity, either individually or as a class, create a potentially significant exposure to the risks described in paragraph 49, terms and conditions that may warrant disclosure include:~~

- ~~(a) The principal, stated, face or other similar amount which, for some derivative instruments, such as interest rate swaps, may be the amount (referred to as the notional amount) on which future payments are based;~~
- ~~(b) The date of maturity, expiry or execution;~~
- ~~(c) Early settlement options held by either party to the instrument, including the period in which, or date at which, the options may be exercised and the exercise price or range of prices;~~
- ~~(d) Options held by either party to the instrument to convert the instrument into, or exchange it for, another financial instrument or some other asset or liability, including the period in which, or date at which, the options may be exercised and the conversion or exchange ratio(s);~~
- ~~(e) The amount and timing of scheduled future cash receipts or payments of the principal amount of the instrument, including installment repayments and any sinking fund or similar requirements;~~
- ~~(f) Stated rate or amount of interest, dividend or other periodic return on principal and the timing of payments;~~
- ~~(g) Collateral held, in the case of a financial asset, or pledged, in the case of a financial liability;~~

- ~~(h) In the case of an instrument for which cash flows are denominated in a currency other than the entity's reporting currency, the currency in which receipts or payments are required;~~
- ~~(i) In the case of an instrument that provides for an exchange, information described in items (a) to (h) for the instrument to be acquired in the exchange; and~~
- ~~(j) Any condition of the instrument or an associated covenant that, if contravened, would significantly alter any of the other terms (for example, a maximum debt to net assets/equity ratio in a bond covenant that, if contravened, would make the full principal amount of the bond due and payable immediately).~~

~~46. When the statement of financial position presentation of a financial instrument differs from the instrument's legal form, it is desirable for an entity to explain in the notes to the financial statements the nature of the instrument.~~

~~47. The usefulness of information about the extent and nature of financial instruments is enhanced when it highlights any relationships between individual instruments that may affect the amount, timing or certainty of the future cash flows of an entity. For example, it is important to disclose hedging relationships such as might exist when a central borrowing authority holds an investment in shares for which it has purchased a put option. Similarly, it is important to disclose relationships between the components of "synthetic instruments" such as fixed rate debt created by borrowing at a floating rate and entering into a floating to fixed interest rate swap. In each case, an entity presents the individual financial assets and financial liabilities in its statement of financial position according to their nature, either separately or in the class of financial asset or financial liability to which they belong. The extent to which a risk exposure is altered by the relationships among the assets and liabilities may be apparent to financial statement users from information of the type described in paragraph 56 but in some circumstances further disclosure is necessary.~~

~~48. In accordance with IPSAS 1, an entity provides clear and concise disclosure of all significant accounting policies, including both the general principles adopted and the method of applying those principles to significant transactions and circumstances arising in the entity's operations. In the case of financial instruments, such disclosure includes:~~

- ~~(a) The criteria applied in determining when to recognize a financial asset or financial liability on the statement of financial position and when to cease to recognize it;~~
- ~~(b) The basis of measurement applied to financial assets and financial liabilities both on initial recognition and subsequently; and~~

- ~~(e) The basis on which revenue and expense arising from financial assets and financial liabilities is recognized and measured.~~

~~49. Types of transactions for which it may be necessary to disclose the relevant accounting policies include:~~

- ~~(a) Transfers of financial assets when there is a continuing interest in, or involvement with, the assets by the transferor, such as securitizations of financial assets, repurchase agreements and reverse repurchase agreements;~~
- ~~(b) Transfers of financial assets to a trust for the purpose of satisfying liabilities when they mature without the obligation of the transferor being discharged at the time of the transfer, such as an in-substance defeasance trust;~~
- ~~(c) Acquisition or issuance of separate financial instruments as part of a series of transactions designed to synthesize the effect of acquiring or issuing a single instrument;~~
- ~~(d) Acquisition or issuance of financial instruments as hedges of risk exposures, such as an interest rate swap to hedge a finance lease obligation; and~~
- ~~(e) Acquisition or issuance of monetary financial instruments bearing a stated interest rate that differs from the prevailing market rate at the date of issue, such as the issue of bonds by a central borrowing authority at a discount. (Refer to Appendix 2, paragraph A26)~~

~~50. To provide adequate information for users of financial statements to understand the basis on which financial assets and financial liabilities have been measured, disclosures of accounting policies indicate not only whether cost, fair value or some other basis of measurement has been applied to a specific class of asset or liability but also the method of applying that basis. For example, for financial instruments carried on the cost basis, an entity may be required to disclose how it accounts for:~~

- ~~(a) Costs of acquisition or issuance;~~
- ~~(b) Premiums and discounts on monetary financial assets and financial liabilities;~~
- ~~(c) Changes in the estimated amount of determinable future cash flows associated with a monetary financial instrument such as a bond indexed to a commodity price;~~
- ~~(d) Changes in circumstances that result in significant uncertainty about the timely collection of all contractual amounts due from monetary financial assets;~~

~~(e)Declines in the fair value of financial assets below their carrying amount; and~~

~~(f)Restructured financial liabilities.~~

~~For financial assets and financial liabilities carried at fair value, an entity indicates whether carrying amounts are determined from quoted market prices, independent appraisals, discounted cash flow analysis or another appropriate method, and discloses any significant assumptions made in applying those methods. (Refer to Appendix 2, paragraph A27.)~~

~~51.An entity discloses the basis for reporting in the statement of financial performance realized and unrealized gains and losses, interest and other items of revenue and expense associated with financial assets and financial liabilities. This disclosure includes information about the basis on which revenue and expense arising from financial instruments held for hedging purposes are recognized. When an entity presents revenue and expense items on a net basis even though the corresponding financial assets and financial liabilities on the statement of financial position have not been offset, the reason for that presentation is disclosed if the effect is significant.~~

Interest Rate Risk

~~52.For each class of financial asset and financial liability, both recognized and unrecognized, an entity should disclose information about its exposure to interest rate risk, including:~~

~~(a)Contractual repricing or maturity dates, whichever dates are earlier; and~~

~~(b)Effective interest rates, when applicable.~~

~~53.An entity provides information concerning its exposure to the effects of future changes in the prevailing level of interest rates. Changes in market interest rates have a direct effect on the contractually determined cash flows associated with some financial assets and financial liabilities (cash flow risk) and on the fair value of others (price risk).~~

~~54.Information about maturity dates, or repricing dates when they are earlier, indicates the length of time for which interest rates are fixed and information about effective interest rates indicates the levels at which they are fixed. Disclosure of this information provides financial statement users with a basis for evaluating the interest rate price risk to which an entity is exposed and thus the potential for gain or loss. For instruments that reprice to a market rate of interest before maturity, disclosure of the period until the next repricing is more important than disclosure of the period to maturity.~~

~~55.To supplement the information about contractual repricing and maturity dates, an entity may elect to disclose information about expected repricing or maturity dates when those dates differ significantly from the contractual dates. Such information may be particularly relevant when, for example, an entity is able to predict, with reasonable reliability, the amount of fixed rate mortgage loans that will be repaid prior to maturity and it uses this data as the basis for managing its interest rate risk exposure. The additional information includes disclosure of the fact that it is based on management's expectations of future events and explains the assumptions made about repricing or maturity dates and how those assumptions differ from the contractual dates.~~

~~56.An entity indicates which of its financial assets and financial liabilities are:~~

- ~~(a)Exposed to interest rate price risk, such as monetary financial assets and financial liabilities with a fixed interest rate;~~
- ~~(b)Exposed to interest rate cash flow risk, such as monetary financial assets and financial liabilities with a floating interest rate that is reset as market rates change; and~~
- ~~(c)Not exposed to interest rate risk, such as some investments in equity securities.~~

~~57.The effective interest rate (effective yield) of a monetary financial instrument is the rate that, when used in a present value calculation, results in the carrying amount of the instrument. The present value calculation applies the interest rate to the stream of future cash receipts or payments from the reporting date to the next repricing (maturity) date and to the expected carrying amount (principal amount) at that date. The rate is a historical rate for a fixed rate instrument carried at amortized cost and a current market rate for a floating rate instrument or an instrument carried at fair value. The effective interest rate is sometimes termed the level yield to maturity or to the next repricing date, and is the internal rate of return of the instrument for that period.~~

~~58.The requirement in paragraph 63(b) applies to bonds, notes and similar monetary financial instruments involving future payments that create a return to the holder and a cost to the issuer reflecting the time value of money. The requirement does not apply to financial instruments such as non-monetary and derivative instruments that do not bear a determinable effective interest rate. For example, while instruments such as interest rate derivatives, including swaps, forward rate agreements and options, are exposed to price or cash flow risk from changes in market interest rates, disclosure of an effective interest rate is not relevant. However, when providing effective interest rate information, an entity discloses the effect~~

~~on its interest rate risk exposure of hedging or “conversion” transactions such as interest rate swaps.~~

~~59. An entity may retain an exposure to the interest rate risks associated with financial assets removed from its statement of financial position as a result of a transaction such as a securitization. Similarly, it may become exposed to interest rate risks as a result of a transaction in which no financial asset or financial liability is recognized on its statement of financial position, such as a commitment to lend funds at a fixed interest rate, or loans to be provided to primary producers during times of drought or other disaster relief. In such circumstances, the entity discloses information that will permit financial statement users to understand the nature and extent of its exposure. In the case of a securitization or similar transfer of financial assets, this information normally includes the nature of the assets transferred, their stated principal, interest rate and term to maturity, and the terms of the transaction giving rise to the retained exposure to interest rate risk. In the case of a commitment to lend funds, the disclosure normally includes the stated principal, interest rate and term to maturity of the amount to be lent and the significant terms of the transaction giving rise to the exposure to risk.~~

~~60. The nature of an entity’s operations and the extent of its activity in financial instruments will determine whether information about interest rate risk is presented in narrative form, in tables, or by using a combination of the two. When an entity has a significant number of financial instruments exposed to interest rate price or cash flow risks, it may adopt one or more of the following approaches to presenting information:~~

~~(a) The carrying amounts of financial instruments exposed to interest rate price risk may be presented in tabular form, grouped by those that are contracted to mature or be repriced:~~

~~(i) Within one year of the reporting date;~~

~~(ii) More than one year and less than five years from the reporting date; and~~

~~(iii) Five years or more from the reporting date.~~

~~(b) When the performance of an entity is significantly affected by the level of its exposure to interest rate price risk or changes in that exposure, more detailed information is desirable. An entity such as a central borrowing authority may disclose, for example, separate groupings of the carrying amounts of financial instruments contracted to mature or be repriced:~~

~~(i) Within one month of the reporting date;~~

~~(ii) More than one and less than three months from the reporting date; and~~

~~(iii) More than three and less than twelve months from the reporting date.~~

~~(e) Similarly, an entity may indicate its exposure to interest rate cash flow risk through a table indicating the aggregate carrying amount of groups of floating rate financial assets and financial liabilities maturing within various future time periods.~~

~~(d) Interest rate information may be disclosed for individual financial instruments or weighted average rates or a range of rates may be presented for each class of financial instrument. An entity groups instruments denominated in different currencies or having substantially different credit risks into separate classes when these factors result in instruments having substantially different effective interest rates.~~

~~61. In some circumstances, an entity may be able to provide useful information about its exposure to interest rate risks by indicating the effect of a hypothetical change in the prevailing level of market interest rates on the fair value of its financial instruments and future earnings and cash flows. Such interest rate sensitivity information may be based on an assumed 1% change in market interest rates occurring at the reporting date. The effects of a change in interest rates includes changes in interest revenue and expense relating to floating rate financial instruments and gains or losses resulting from changes in the fair value of fixed rate instruments. The reported interest rate sensitivity may be restricted to the direct effects of an interest rate change on interest-bearing financial instruments on hand at the reporting date since the indirect effects of a rate change on financial markets and individual entities cannot normally be predicted reliably. When disclosing interest rate sensitivity information, an entity indicates the basis on which it has prepared the information, including any significant assumptions.~~

Credit Risk

~~62. For each class of financial asset, both recognized and unrecognized, an entity should disclose information about its exposure to credit risk, including:~~

~~(a) The amount that best represents its maximum credit risk exposure at the reporting date, without taking account of the fair value of any collateral, in the event other parties fail to perform their obligations under financial instruments; and~~

(b) Significant concentrations of credit risk.

~~63. An entity provides information relating to credit risk to permit users of its financial statements to assess the extent to which failures by counterparties to discharge their obligations could reduce the amount of future cash inflows from financial assets on hand at the reporting date. Such failures give rise to a financial loss recognized in an entity's statement of financial performance. Paragraph 73 does not require an entity to disclose an assessment of the probability of losses arising in the future.~~

~~64. The purposes of disclosing amounts exposed to credit risk without regard to potential recoveries from realization of collateral ("an entity's maximum credit risk exposure") are:~~

~~(a) To provide users of financial statements with a consistent measure of the amount exposed to credit risk for both recognized and unrecognized financial assets; and~~

~~(b) To take into account the possibility that the maximum exposure to loss may differ from the carrying amount of a recognized financial asset or the fair value of an unrecognized financial asset that is otherwise disclosed in the financial statements.~~

~~65. In the case of recognized financial assets exposed to credit risk, the carrying amount of the assets in the statement of financial position, net of any applicable provisions for loss, usually represents the amount exposed to credit risk. For example, in the case of an interest rate swap carried at fair value, the maximum exposure to loss at the reporting date is normally the carrying amount since it represents the cost, at current market rates, of replacing the swap in the event of default. In these circumstances, no additional disclosure beyond that provided on the statement of financial position is necessary. On the other hand, as illustrated by the examples in paragraphs 77 and 78, an entity's maximum potential loss from some recognized financial assets may differ significantly from their carrying amount and from other disclosed amounts such as their fair value or principal amount. In such circumstances, additional disclosure is necessary to meet the requirements of paragraph 73(a).~~

~~66. A financial asset subject to a legally enforceable right of set off against a financial liability is not presented on the statement of financial position net of the liability unless settlement is intended to take place on a net basis or simultaneously. Nevertheless, an entity discloses the existence of the legal right of set off when providing information in accordance with paragraph 73. For example, when an entity is due to receive the proceeds from realization of a financial asset before settlement of a financial liability of equal or greater amount against which the entity has a legal right of set off,~~

~~the entity has the ability to exercise that right of set-off to avoid incurring a loss in the event of a default by the counterparty. However, if the entity responds, or is likely to respond, to the default by extending the term of the financial asset, an exposure to credit risk would exist if the revised terms are such that collection of the proceeds is expected to be deferred beyond the date on which the liability is required to be settled. To inform financial statement users of the extent to which exposure to credit risk at a particular point in time has been reduced, the entity discloses the existence and effect of the right of set-off when the financial asset is expected to be collected in accordance with its terms. When the financial liability against which a right of set-off exists is due to be settled before the financial asset, the entity is exposed to credit risk on the full carrying amount of the asset if the counterparty defaults after the liability has been settled.~~

~~67. An entity may have entered into one or more master netting arrangements that serve to mitigate its exposure to credit loss but do not meet the criteria for offsetting. When a master netting arrangement significantly reduces the credit risk associated with financial assets not offset against financial liabilities with the same counterparty, an entity provides additional information concerning the effect of the arrangement. Such disclosure indicates that:~~

- ~~(a) The credit risk associated with financial assets subject to a master netting arrangement is eliminated only to the extent that financial liabilities due to the same counterparty will be settled after the assets are realized; and~~
- ~~(b) The extent to which an entity's overall exposure to credit risk is reduced through a master netting arrangement may change substantially within a short period following the reporting date because the exposure is affected by each transaction subject to the arrangement.~~

~~It is also desirable for an entity to disclose the terms of its master netting arrangements that determine the extent of the reduction in its credit risk:~~

~~68. When there is no credit risk associated with an unrecognized financial asset or the maximum exposure is equal to the principal, stated, face or other similar contractual amount of the instrument disclosed in accordance with paragraph 54 or the fair value disclosed in accordance with paragraph 84, no additional disclosure is required to comply with paragraph 73(a). However, with some unrecognized financial assets, the maximum loss that would be recognized upon default by the other party to the underlying instrument may differ substantially from the amounts disclosed in accordance with paragraphs 54 and 84. For example, an entity may have a right to mitigate the loss it would otherwise bear by setting off an unrecognized financial asset against an unrecognized financial liability. In~~

such circumstances, paragraph 73(a) requires disclosure in addition to that provided in accordance with paragraphs 54 and 84.

69. ~~Guaranteeing an obligation of another party exposes the guarantor to credit risk that would be taken into account in making the disclosures required by paragraph 73. This situation may arise as a result of, for example, a securitization transaction in which an entity remains exposed to credit risk associated with financial assets that have been removed from its statement of financial position. If the entity is obligated under recourse provisions of the transaction to indemnify the purchaser of the assets for credit losses, it discloses the nature of the assets removed from its statement of financial position, the amount and timing of the future cash flows contractually due from the assets, the terms of the recourse obligation and the maximum loss that could arise under that obligation. Similarly, where a local government guarantees the obligations of a private sector provider of public infrastructure, the maximum loss that could arise under that obligation in the event of default of the provider should be disclosed.~~

70. ~~Concentrations of credit risk are disclosed when they are not apparent from other disclosures about the nature and financial position of the entity and they result in a significant exposure to loss in the event of default by other parties. Identification of significant concentrations is a matter for the exercise of judgment by management taking into account the circumstances of the entity and its debtors.~~

71. ~~Concentrations of credit risk may arise from exposures to a single debtor or to groups of debtors having a similar characteristic such that their ability to meet their obligations is expected to be affected similarly by changes in economic or other conditions. Characteristics that may give rise to a concentration of risk include the nature of the activities undertaken by debtors, such as the industry in which they operate, the geographic area in which activities are undertaken and the level of creditworthiness of groups of borrowers. For example, a state-owned coal mine will normally have trade accounts receivable from sale of its products for which the risk of non-payment is affected by economic changes in the electricity generation industry. A bank that normally lends on an international scale may have a significant amount of loans outstanding to less developed nations and the bank's ability to recover those loans may be adversely affected by local economic conditions.~~

72. ~~Disclosure of concentrations of credit risk includes a description of the shared characteristic that identifies each concentration and the amount of the maximum credit risk exposure associated with all recognized and unrecognized financial assets sharing that characteristic.~~

Fair Value

~~73. For each class of financial asset and financial liability, both recognized and unrecognized, an entity should disclose information about fair value. When it is not practicable within constraints of timeliness or cost to determine the fair value of a financial asset or financial liability with sufficient reliability, that fact should be disclosed together with information about the principal characteristics of the underlying financial instrument that are pertinent to its fair value.~~

~~74. Fair value information is widely used for financial purposes in determining an entity's overall financial position and in making decisions about individual financial instruments. It is also relevant to many decisions made by users of financial statements since, in many circumstances, it reflects the judgment of the financial markets as to the present value of expected future cash flows relating to an instrument. Fair value information permits comparisons of financial instruments having substantially the same economic characteristics, regardless of their purpose and when and by whom they were issued or acquired. Fair values provide a neutral basis for assessing management's stewardship by indicating the effects of its decisions to buy, sell or hold financial assets and to incur, maintain or discharge financial liabilities. When an entity does not carry a financial asset or financial liability in its statement of financial position at fair value, it provides fair value information through supplementary disclosures.~~

~~75. The fair value of a financial asset or financial liability may be determined by one of several generally accepted methods. Disclosure of fair value information includes disclosure of the method adopted and any significant assumptions made in its application.~~

~~76. Underlying the definition of fair value is a presumption that an entity is a going concern without any intention or need to liquidate, curtail materially the scale of its operations or undertake a transaction on adverse terms. Fair value is not, therefore, the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale. However, an entity takes its current circumstances into account in determining the fair values of its financial assets and financial liabilities. For example, the fair value of a financial asset that an entity has decided to sell for cash in the immediate future is determined by the amount that it expects to receive from such a sale. The amount of cash to be realized from an immediate sale will be affected by factors such as the current liquidity and depth of the market for the asset.~~

~~77. When a financial instrument is traded in an active and liquid market, its quoted market price provides the best evidence of fair value. The appropriate~~

quoted market price for an asset held or liability to be issued is usually the current bid price and, for an asset to be acquired or liability held, the current offer or asking price. When current bid and offer prices are unavailable, the price of the most recent transaction may provide evidence of the current fair value provided that there has not been a significant change in economic circumstances between the transaction date and the reporting date. When an entity has matching asset and liability positions, it may appropriately use mid-market prices as a basis for establishing fair values.

78. When there is infrequent activity in a market, the market is not well established (for example, some “over the counter” markets) or small volumes are traded relative to the number of trading units of a financial instrument to be valued, quoted market prices may not be indicative of the fair value of the instrument. In these circumstances, as well as when a quoted market price is not available, estimation techniques may be used to determine fair value with sufficient reliability to satisfy the requirements of this Standard. Techniques that are well established in financial markets include reference to the current market value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. In applying discounted cash flow analysis, an entity uses a discount rate equal to the prevailing market rate of interest for financial instruments having substantially the same terms and characteristics, including the creditworthiness of the debtor, the remaining term over which the contractual interest rate is fixed, the remaining term to repayment of the principal and the currency in which payments are to be made.

79. The fair value to an entity of a financial asset or financial liability, whether determined from market value or otherwise, is determined without deduction for the costs that would be incurred to exchange or settle the underlying financial instrument. The costs may be relatively insignificant for instruments traded in organized, liquid markets but may be substantial for other instruments. Transaction costs may include taxes and duties, fees and commissions paid to agents, advisers, brokers or dealers and levies by regulatory agencies or securities exchanges.

80. When an instrument is not traded in an organized financial market, it may not be appropriate for an entity to determine and disclose a single amount that represents an estimate of fair value. Instead, it may be more useful to disclose a range of amounts within which the fair value of a financial instrument is reasonably believed to lie.

81. When disclosure of fair value information is omitted because it is not practicable to determine fair value with sufficient reliability, information is provided to assist users of the financial statements in making their own judgments about the extent of possible differences between the carrying amount of financial

~~assets and financial liabilities and their fair value. In addition to an explanation of the reason for the omission and the principal characteristics of the financial instruments that are pertinent to their value, information is provided about the market for the instruments. In some cases, the terms and conditions of the instruments disclosed in accordance with paragraph 54 may provide sufficient information about the characteristics of the instrument. When it has a reasonable basis for doing so, management may indicate its opinion as to the relationship between fair value and the carrying amount of financial assets and financial liabilities for which it is unable to determine fair value.~~

~~82.The historical cost carrying amount of receivables and payables subject to normal trade credit terms usually approximates fair value. Similarly, the fair value of a deposit liability without a specified maturity is the amount payable on demand at the reporting date.~~

~~83.Fair value information relating to classes of financial assets or financial liabilities that are carried on the statement of financial position at other than fair value is provided in a way that permits comparison between the carrying amount and the fair value. Accordingly, the fair values of recognized financial assets and financial liabilities are grouped into classes and offset only to the extent that their related carrying amounts are offset. Fair values of unrecognized financial assets and financial liabilities are presented in a class or classes separate from recognized items and are offset only to the extent that they meet the offsetting criteria for recognized financial assets and financial liabilities.~~

Financial Assets Carried at an Amount in Excess of Fair Value

~~84.When an entity carries one or more financial assets at an amount in excess of their fair value, the entity should disclose:~~

- ~~(a)The carrying amount and the fair value of either the individual assets or appropriate groupings of those individual assets; and~~
- ~~(b)The reasons for not reducing the carrying amount, including the nature of the evidence that provides the basis for management's belief that the carrying amount will be recovered.~~

~~85.Management exercises judgment in determining the amount it expects to recover from a financial asset and whether to write down the carrying amount of the asset when it is in excess of fair value. The information required by paragraph 95 provides users of financial statements with a basis for understanding management's exercise of judgment and assessing the possibility that circumstances may change and lead to a reduction in the asset's carrying amount in the future. When appropriate, the information~~

~~required by paragraph 95(a) is grouped in a manner that reflects management's reasons for not reducing the carrying amount.~~

~~86. An entity's accounting policies with respect to recognition of declines in value of financial assets, disclosed in accordance with paragraph 54, assist in explaining why a particular financial asset is carried at an amount in excess of fair value. In addition, the entity provides the reasons and evidence specific to the asset that provide management with the basis for concluding that the asset's carrying amount will be recovered. For example, the fair value of a fixed rate loan intended to be held to maturity may have declined below its carrying amount as a result of an increase in interest rates. In such circumstances, the lender may not have reduced the carrying amount because there is no evidence to suggest that the borrower is likely to default.~~

Hedges of Anticipated Future Transactions

~~87. When an entity has accounted for a financial instrument as a hedge of risks associated with anticipated future transactions, it should disclose:~~

- ~~(a) A description of the anticipated transactions, including the period of time until they are expected to occur;~~
- ~~(b) A description of the hedging instruments; and~~
- ~~(c) The amount of any deferred or unrecognized gain or loss and the expected timing of recognition as revenue or expense.~~

~~88. An entity's accounting policies indicate the circumstances in which a financial instrument is accounted for as a hedge and the nature of the special recognition and measurement treatment applied to the instrument. The information required by paragraph 98 permits the users of an entity's financial statements to understand the nature and effect of a hedge of an anticipated future transaction. The information may be provided on an aggregate basis when a hedged position comprises several anticipated transactions or has been hedged by several financial instruments.~~

~~89. The amount disclosed in accordance with paragraph 98(c) includes all accrued gains and losses on financial instruments designated as hedges of anticipated future transactions, without regard to whether those gains and losses have been recognized in the financial statements. The accrued gain or loss may be unrealized but recorded in the entity's statement of financial position as a result of carrying the hedging instrument at fair value, it may be unrecognized if the hedging instrument is carried on the cost basis, or it may have been realized if the hedging instrument has been sold or settled. In each case, however, the accrued gain or loss on the hedging instrument~~

~~has not been recognized in the entity's statement of financial performance pending completion of the hedged transaction.~~

Other Disclosures

~~90. Additional disclosures are encouraged when they are likely to enhance financial statement users' understanding of financial instruments. It may be desirable to disclose such information as:~~

- ~~(a) The total amount of the change in the fair value of financial assets and financial liabilities that has been recognized as revenue or expense for the period;~~
- ~~(b) The total amount of deferred or unrecognized gain or loss on hedging instruments other than those relating to hedges of anticipated future transactions; and~~
- ~~(c) The average aggregate carrying amount during the year of recognized financial assets and financial liabilities, the average aggregate principal, stated, notional or other similar amount during the year of unrecognized financial assets and financial liabilities and the average aggregate fair value during the year of all financial assets and financial liabilities, particularly when the amounts on hand at the reporting date are unrepresentative of amounts on hand during the year.~~

Transitional Provision

~~91. When comparative information for prior periods is not available when this International Public Sector Accounting Standard is first adopted, such information need not be presented.~~

Staff are of the view that this transitional provision replicates IPSAS 3, paragraphs 27 – 30 and is, therefore, unnecessary.

Effective Date

~~103.60.~~ This International Public Sector Accounting Standard becomes effective for annual financial statements covering periods beginning on or after ~~January 1, 2003~~ Month XX, 20XX. Earlier application is encouraged.

~~104.61.~~ When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

Appendix 21

Examples of the Application of the StandardApplication Guidance

IPSAS 15, “Financial Instruments: Presentation”

~~This appendix is illustrative only and does not form part of the standards an integral part of the Standard. The purpose of the appendix is to illustrate the application of the standards to assist in clarifying their meaning.~~

Amended as per IASB improvements project, ref IAS 32, Appendix AG1. Staff have moved this appendix forward as it is now an integral part of the Standard.

A1-AG1. This appendix explains and illustrates the application of ~~certain particular~~ aspects of the Standard. ~~to various common financial instruments.~~

~~The detailed examples are illustrative only and do not necessarily represent the only basis for applying the Standard in the specific circumstances discussed. Changing one or two of the facts assumed in the examples can lead to substantially different conclusions concerning the appropriate presentation or disclosure of a particular financial instrument. This appendix does not discuss the application of all requirements of the Standard in the examples provided. In all cases, the provisions of the Standard prevail.~~

A2-AG2. The Standard does not deal with the recognition or measurement of financial instruments. ~~Certain recognition and measurement practices may be assumed for purposes of illustration but they are not required.~~

Amended as per IASB improvements project, ref IAS 32, AG2.

Definitions

~~Common Types of Financial Instruments, Financial Assets and Financial Liabilities~~

A3-AG3. Currency (cash) is a financial asset because it represents the medium of exchange and is therefore the basis on which all transactions are measured and reported in financial statements. A deposit of cash with a bank or similar financial institution is a financial asset because it represents the contractual right of the depositor to obtain cash from the institution or to draw a check or similar instrument against the balance in favor of a creditor in payment of a financial liability. This Standard does not address currency issued by the entity.

Amended to note that the IPSAS does not address currency issued by the entity.

A4-AG4. Common examples of financial assets representing a contractual right to receive cash in the future and corresponding financial liabilities representing a contractual obligation to deliver cash in the future are:

- (a) Trade accounts receivable and payable;
- (b) Notes receivable and payable;
- (c) Loans receivable and payable; and
- (d) Bonds receivable and payable.

In each case, one party's contractual right to receive (or obligation to pay) cash is matched by the other party's corresponding obligation to pay (or right to receive).

A5-AG5. Another type of financial instrument is one for which the economic benefit to be received or given up is a financial asset other than cash. For example, a note payable in highly rated bonds gives the holder the contractual right to receive and the issuer the contractual obligation to deliver bonds, not cash. The bonds are financial assets because they represent obligations of the issuer to pay cash. The note is, therefore, a financial asset of the note holder and a financial liability of the note issuer.

AG6. "Perpetual" debt instruments, such as "perpetual" bonds, debentures and capital notes, normally provide the holder with the contractual right to receive payments on account of interest at fixed dates extending into the indefinite future, either with no right to receive a return of principal or a right to a return of principal under terms that make it very unlikely or very far in the future. For example, an entity may issue a financial instrument requiring it to make annual payments in perpetuity equal to a stated interest rate of 8% applied to a stated par or principal amount of CU1,000. Assuming 8% to be the market rate of interest for the instrument when issued, the issuer assumes a contractual obligation to make a stream of future interest payments having a fair value (present value) of CU1,000 on initial recognition. The holder and issuer of the instrument have a financial asset and financial liability, respectively.

Paragraphs moved, as per as per IASB improvements project, ref IAS 32.AG6 – AG8.

AG7. A contractual right or contractual obligation to receive, deliver or exchange financial instruments is itself a financial instrument. A chain of contractual rights or contractual obligations meets the definition of a financial instrument if it will ultimately lead to the receipt or payment of cash or to the acquisition or issue of an equity instrument.

AG8. The ability to exercise a contractual right or the requirement to satisfy a contractual obligation may be absolute, or it may be contingent on the occurrence of a future event. For example, a financial guarantee is a contractual right of the lender to receive cash from the guarantor, and a corresponding contractual obligation of the guarantor to pay the lender, if the borrower defaults. The contractual right and obligation exist because of a past transaction or event (assumption of the guarantee), even though the lender's ability to exercise its right and the requirement for the guarantor to perform under its obligation are both contingent on a future act of default by the borrower. A contingent right and obligation meet the definition of a financial asset and a financial liability, even though such assets and liabilities are not always recognized in the financial statements. Some of these contingent rights and obligations may be insurance contracts within the scope of international or national accounting standards addressing insurance contracts.

AG9. Under IPSAS 13, "Leases." a finance lease is ~~accounted for as a sale with delayed payment terms. The lease contract is considered to be regarded~~ as primarily an entitlement of the lessor to receive, and an obligation of the lessee to pay, a stream of payments that are substantially the same as blended payments of principal and interest under a loan agreement. The lessor accounts for its investment in the amount receivable under the lease contract rather than the leased asset itself. An operating lease, on the other hand, is considered to be primarily an uncompleted contract committing the lessor to provide the use of an asset in future periods in exchange for consideration similar to a fee for a service. The lessor continues to account for the leased asset itself rather than any amount receivable in the future under the contract. Accordingly, a finance lease is considered to be a financial instrument and an operating lease is considered not to be a financial instrument (except as regards individual payments currently due and payable).

Amended as per
IASB
improvements
project, ref IAS
32. AG9.

AG10. Physical assets (such as inventories, property, plant and equipment), leased assets and intangible assets (such as patents and trademarks) are not financial assets. Control of such physical and intangible assets creates an opportunity to generate an inflow of cash or another financial asset, but it does not give rise to a present right to receive cash or another financial asset.

Paragraphs
AG10 – AG12
inserted as per
IASB
improvements
project, ref IAS
32. AG10 –
AG12.

AG11. Assets (such as prepaid expenses) 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 deferred revenue and most warranty obligations are not

financial liabilities because the outflow of economic benefits associated with them is the delivery of goods and services rather than a contractual obligation to pay cash or another financial asset.

AG12. Liabilities or assets that are not contractual (such as income taxes payable that are created as a result of statutory requirements imposed by governments) are not financial liabilities or financial assets. Accounting for income taxes by taxpayers is dealt with in international and national accounting standards addressing income taxes. Similarly, constructive obligations, as defined in IPSAS 19, “Provisions, Contingent Liabilities and Contingent Assets,” do not arise from contracts and are not financial liabilities.

AG12 notes that it is taxes payable by taxpayers (not income taxes generally).

Equity Instruments

A7-AG13. Equity instruments are not commonly issued by public sector entities except for partly-privatized GBEs. Examples of equity instruments include ~~common non-puttable ordinary~~ shares, certain types of ~~preferred preference~~ shares (see paragraphs AG24 and AG25), and warrants or written call options that allow the holder to subscribe for or purchase a fixed number of non-puttable ordinary ~~common~~ shares in the issuing entity in exchange for a fixed amount of cash or another financial asset. An entity’s obligation to issue or purchase a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument of the entity. However, if such a contract contains an obligation for the entity to pay cash or another financial assets, it also gives rise to a liability for the present value of the redemption amount (see paragraph AG26(a)). An issuer of non-puttable ordinary shares assumes a liability when it formally acts to make a distribution and becomes legally obligated to the shareholders to do so. This may be the case following the declaration of a dividend or similar distribution or when the entity is being wound up an any assets remaining after the satisfaction of liabilities become distributable to shareholders. of another party is not potentially unfavorable since it results in an increase in net assets/equity and cannot result in a loss to the entity. The possibility that existing holders of a net assets/equity interest in the entity may find the fair value of their interest reduced as a result of the obligation does not make the obligation unfavorable to the entity itself.

Amended as per IASB improvements project, ref IAS 32.AG13.

A8-AG14. An purchased call option or other similar instrument acquired by an entity that gives it the right to reacquire a fixed number of its own equity instruments in exchange for delivering

Amended as per IASB improvements project, ref IAS 32.AG14.

a fixed amount of cash or another financial asset is not a financial asset of the entity. Instead, any consideration paid for such a contract is deducted from net assets. ~~The entity will not receive cash or any other financial asset through exercise of the option. Exercise of the option is not potentially favorable to the entity since it results in a reduction in net assets/equity and an outflow of assets. Any change in net assets/equity recorded by the entity from reacquiring and canceling its own equity instruments represents a transfer between those holders of equity instruments who have given up their net assets/equity interest and those who continue to hold a net assets/equity interest, rather than a gain or loss by the entity.~~

Derivative ~~F~~financial ~~I~~struments

A9-AG15. Financial instruments include primary instruments

(such as receivables, payables and equity instruments) and derivative financial instruments (such as financial options, futures and forwards, interest rate swaps and currency swaps). Derivative financial instruments meet the definition of a financial instrument and, accordingly, are within the scope of this Standard.

Amended as per
IASB
improvements
project, ref IAS
32.AG15.

~~On inception, derivative financial instruments give one party a contractual right to exchange financial assets with another party under conditions that are potentially favorable, or a contractual obligation to exchange financial assets with another party under conditions that are potentially unfavorable. Some instruments embody both a right and an obligation to make an exchange. Since the terms of the exchange are determined on inception of the derivative instrument, as prices in financial markets change, those terms may become either favorable or unfavorable.~~

AG16. Derivative financial instruments create rights and obligations that have the

effect of transferring between the parties to the instrument one or more of the financial risks inherent in an underlying primary financial instrument. On inception, derivative financial instruments give one party a contractual right to exchange financial assets or financial liabilities with another party under conditions that are potentially favorable, or a

Inserted as per
IASB
improvements
project, ref IAS
32.AG16.

contractual obligation to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavorable. However, they generally¹ do not result in a transfer of the underlying primary financial instrument on inception of the contract, nor does such a

¹ This is true of most, but not all derivatives, e.g. in some cross-currency interest rate swaps principal is exchanged on inception (and re-exchanged on maturity).

transfer necessarily take place on maturity of the contract. Some instruments embody both a right and an obligation to make an exchange. Because the terms of the exchange are determined on inception of the derivative instrument, as prices in financial markets change those terms may become either favorable or unfavorable.

A10-AG17. A put or call option to exchange financial assets or financial liabilities (i.e. financial instruments other than an entity's own financial instruments) gives the holder a right to obtain potential future economic benefits associated with changes in the fair value of the financial instrument underlying the contract. Conversely, the writer of an option assumes an obligation to forego potential future economic benefits or bear potential losses of economic benefits associated with changes in the fair value of the underlying financial instrument. The contractual right of the holder and obligation of the writer meet the definition of a financial asset and a financial liability respectively. The financial instrument underlying an option contract may be any financial asset, including shares in other entities and interest-bearing instruments. An option may require the writer to issue a debt instrument, rather than transfer a financial asset, but the instrument underlying the option would still constitute a financial asset of the holder if the option were exercised. The option-holder's right to exchange the assets under potentially favorable conditions and the writer's obligation to exchange the assets under potentially unfavorable conditions are distinct from the underlying assets to be exchanged upon exercise of the option. The nature of the holder's right and the writer's obligation is not affected by the likelihood that the option will be exercised. ~~An option to buy or sell an asset other than a financial asset (such as a commodity) does not give rise to a financial asset or financial liability because it does not fit the requirements of the definitions for the receipt or delivery of financial assets or exchange of financial instruments.~~

Amended as per
IASB
improvements
project, ref IAS
32.AG17.

A11-AG18. Another example of a derivative financial instrument is a forward contract to be settled in six months' time in which one party (the purchaser) promises to deliver CU1,000,000 cash in exchange for CU1,000,000 face amount of fixed rate government bonds, and the other party (the seller) promises to deliver CU1,000,000 face amount of fixed rate government bonds in exchange for CU1,000,000 cash. During the six months, both parties have a contractual right and a contractual obligation to exchange financial instruments. If the market price of the government bonds rises above CU1,000,000, the conditions will be favorable to the purchaser and unfavorable to the seller; if the market price falls below CU1,000,000, the

Amended as per
IASB
improvements
project, ref IAS
32.AG18.

effect will be the opposite. The purchaser has both a contractual right (a financial asset) similar to the right under a call option held and a contractual obligation (a financial liability) similar to the obligation under a put option written; the seller has a contractual right (a financial asset) similar to the right under a put option held and a contractual obligation (a financial liability) similar to the obligation under a call option written. As with options, these contractual rights and obligations constitute financial assets and financial liabilities separate and distinct from the underlying financial instruments (the bonds and cash to be exchanged). Both parties to a forward contract have an obligation to perform at the agreed time, whereas performance under an option contract occurs only if and when the holder of the option chooses to exercise it. ~~The significant difference between a forward contract and an option contract is that both parties to a forward contract have an obligation to perform at the agreed time, whereas performance under an option contract occurs only if and when the holder of the option chooses to exercise it.~~

A12-AG19. Many other types of derivative instruments embody a right or obligation to make a future exchange, including interest rate and currency swaps, interest rate caps, collars and floors, loan commitments, note issuance facilities and letters of credit. An interest rate swap contract may be viewed as a variation of a forward contract in which the parties agree to make a series of future exchanges of cash amounts, one amount calculated with reference to a floating interest rate and the other with reference to a fixed interest rate. Futures contracts are another variation of forward contracts, differing primarily in that the contracts are standardized and traded on an exchange.

~~Commodity Contracts and Commodity-linked Financial Instruments to buy or sell non-financial items (see paragraphs 11 to 13)~~

A13-AG20. Contracts to buy or sell non-financial items do not meet the definition of a financial instrument because the contractual right of one party to receive a non-financial asset or service and the corresponding obligation of the other party do not establish a present right or obligation of either party to receive, deliver or exchange a financial asset. For example, ~~As indicated by paragraph 18 of the Standard,~~ contracts that provide for settlement by receipt or delivery of a ~~physical asset only~~ non-financial item ~~(for example,~~ e.g., an option, futures or forward contract on silver) are not financial instruments. Many commodity contracts are of this type. Some are standardized in form and traded on organized markets in much the same fashion as some derivative financial instruments. For example, a commodity futures contract may be readily bought and sold for cash because it is listed

Amended as per IASB improvements project, ref IAS 32.AG20.

for trading on an exchange and may change hands many times. However, the parties buying and selling the contract are, in effect, trading the underlying commodity. The ability to buy or sell a commodity contract for cash, the ease with which it may be bought or sold and the possibility of negotiating a cash settlement of the obligation to receive or deliver the commodity do not alter the fundamental character of the contract in a way that creates a financial instrument. Nevertheless, some contracts to buy or sell non-financial items that can be settled net or by exchanging financial instruments, or in which the non-financial item is readily convertible to cash, are within the scope of the Standard as if they were financial instruments (see paragraph 11).

A14-AG21. A contract that involves receipt or delivery of physical assets does not give rise to a financial asset of one party and a financial liability of the other party unless any corresponding payment is deferred past the date on which the physical assets are transferred. Such is the case with the purchase or sale of goods on trade credit.

A15-AG22. Some contracts are commodity-linked but do not involve settlement through physical receipt or delivery of a commodity. They specify settlement through cash payments that are determined according to a formula in the contract, rather than through payment of fixed amounts. For example, the principal amount of a bond may be calculated by applying the market price of oil prevailing at the maturity of the bond to a fixed quantity of oil. The principal is indexed by reference to a commodity price but is settled only in cash. Such a contract constitutes a financial instrument.

A16-AG23. The definition of a financial instrument encompasses also a contract that gives rise to a non-financial asset or liability in addition to a financial asset or liability. Such financial instruments often give one party an option to exchange a financial asset for a non-financial asset. For example, an oil-linked bond may give the holder the right to receive a stream of fixed periodic interest payments and a fixed amount of cash on maturity, with the option to exchange the principal amount for a fixed quantity of oil. The desirability of exercising this option will vary from time to time ~~based~~ depending on the fair value of oil relative to the exchange ratio of cash for oil (the exchange price) inherent in the bond. The intentions of the bondholder concerning the exercise of the option do not affect the substance of the component assets. The financial asset of the holder and the financial liability of the issuer make the bond a financial instrument, regardless of the other types of assets and liabilities also created.

~~A17. Although the Standard was not developed to apply to commodity or other contracts that do not satisfy the definition of a financial instrument, entities may~~

Deleted as per IASB improvements project.

~~consider whether it is appropriate to apply the relevant portions of the disclosure standards to such contracts.~~

Presentation

Liabilities and ~~Net Assets/Equity~~ (see paragraphs 18 to 35)

No contractual obligation to deliver cash or another asset (see paragraphs 20 to 28)

~~A18. Although it is not common for public sector entities to issue equity instruments, in the event that such instruments are issued, it is relatively easy for issuers to classify certain types of financial instruments as liabilities or net assets/equity. Examples of equity instruments include common (ordinary) shares and options that, if exercised, would require the writer of the option to issue common shares. Common shares do not oblige the issuer to transfer assets to shareholders, except when the issuer formally acts to make a distribution and becomes legally obligated to the shareholders to do so. This may be the case following declaration of a dividend or when the entity is being wound up and any assets remaining after the satisfaction of liabilities become distributable to shareholders.~~

Deleted as per IASB improvements project.

~~“Perpetual” Debt Instruments~~

~~A19. “Perpetual” debt instruments, such as “perpetual” bonds, debentures and capital notes, normally provide the holder with the contractual right to receive payments on account of interest at fixed dates extending into the indefinite future, either with no right to receive a return of principal or a right to a return of principal under terms that make it very unlikely or very far in the future. For example, an entity may issue a financial instrument requiring it to make annual payments in perpetuity equal to a stated interest rate of 8% applied to a stated par or principal amount of 1,000. Assuming 8% to be the market rate of interest for the instrument when issued, the issuer assumes a contractual obligation to make a stream of future interest payments having a fair value (present value) of 1,000. The holder and issuer of the instrument have a financial asset and financial liability, respectively, of 1,000 and corresponding interest revenue and expense of 80 each year in perpetuity.~~

Relocated to AG6 as per IASB improvements project.

~~Preferred Shares~~

~~A20:AG24. Preferred Preference (or preference) shares may be issued with various rights. In classifying-determining whether a preferred preference share as-is a financial liability or net~~

Amended as per IASB improvements project, ref IAS 32.AG24.

~~assets/equity~~ an equity instrument, an ~~entity-issuer~~ assesses the particular rights attaching to the share to determine whether it exhibits the fundamental characteristic of a financial liability. For example, a ~~preferred preference~~ share that provides for redemption on a specific date or at the option of the holder meets the definition of a financial liability if the issuer has an obligation to transfer financial assets to the holder of the share. The ~~potential~~ inability of an issuer to satisfy an obligation to redeem a ~~preferred preference~~ share when contractually required to do so, whether ~~due to~~ because of a lack of funds, ~~or~~ a statutory restriction, or insufficient surpluses or reserves, does not negate the obligation. An option of the issuer to redeem the shares for cash does not satisfy the definition of a financial liability because the issuer does not have a present obligation to transfer financial assets to the shareholders. In this case, Redemption-redemption of the shares is solely at the discretion of the issuer. An obligation may arise, however, when the issuer of the shares exercises its option, usually by formally notifying the shareholders of an intention to redeem the shares.

A21-AG25. When ~~preferred preference~~ shares are non-redeemable, the appropriate classification is determined by the other rights that may attach to them. Classification is based on an assessment of the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument. When distributions to holders of the ~~preferred preference~~ shares whether, cumulative or non-cumulative, are at the discretion of the issuer, the shares are equity instruments. The classification of a preference share as an equity instrument or a financial liability is not affected by, for example:

Amended as per IASB improvements project, ref IAS 32.AG25.

- (a) A history of making distributions;
- (b) An intention to make distributions in the future;
- (c) A possible negative impact on the price of ordinary shares of the issuer if distributions are not made (because of restrictions on paying dividends or similar distributions on the ordinary shares if dividends or similar distributions are not paid on the preference shares);
- (d) The amount of the issuer's reserves;
- (e) An issuer's expectation of a surplus or deficit for a period; or
- (f) An ability or inability of the issuer to influence the amount of its surplus or deficit for the period.

Settlement in the entity's own equity instruments (see paragraphs 29 to 32)

AG26. The following examples illustrate how to classify different types of contracts on an entity's own equity instruments:

Paragraphs
AG26 – AG28
inserted as per
IASB
improvements
project, ref IAS
32.AG26 –
AG28.

- (a) A contract that will be settled by the entity receiving or delivering a fixed number of its own shares for no future consideration, or exchanging a fixed number of its own shares for a fixed amount of cash or another financial asset, is an equity instrument. Accordingly, any consideration received or paid for such a contract is added directly to or deducted directly from net assets. One example is an issued share option that gives the counterparty a right to buy a fixed number of the entity's shares for a fixed amount of cash. However, if the contract requires the entity to purchase (redeem) its own shares for cash or another financial asset at a fixed or determinable date or on demand, the entity also recognizes a financial liability for the present value of the redemption amount. One example is an entity's obligation under a forward contract to repurchase a fixed number of its own shares for a fixed amount of cash.
- (b) An entity's obligation to purchase its own shares for cash gives rise to a financial liability for the present value of the redemption amount even if the number of shares that the entity is obliged to repurchase is not fixed or if the obligation is conditional on the counterparty exercising a right to redeem. One example of a conditional obligation is an issued option that requires the entity to repurchase its own shares for cash if the counterparty exercises the option.
- (c) A contract that will be settled in cash or another financial asset is a financial asset or financial liability even if the amount of cash or another financial asset that will be received or delivered is based on changes in the market price of the entity's own net assets. One example is a net cash-settled share option.
- (d) A contract that will be settled in a variable number of the entity's own shares whose value equals a fixed amount or an amount based on changes in an underlying variable (e.g. a commodity price) is a financial asset or a financial liability. An example is a written option to buy gold that, if exercised, is settled net in the entity's own instruments by the entity delivering as many of those

instruments as are equal to the value of the option contract. Such a contract is a financial asset or financial liability even if the underlying variable is the entity's own share price rather than gold. Similarly, a contract that will be settled in a fixed number of the entity's own shares, but the rights attaching to those shares will be varied so that the settlement value equals a fixed amount or an amount based on changes in an underlying variable, is a financial asset or a financial liability.

Contingent settlement provisions (see paragraph 33)

AG27. Paragraph 33 requires that if a part of a contingent settlement provision that could require settlement in cash or another financial asset (or in another way that would result in the instrument being a financial liability) is not genuine, the settlement provision does not affect the classification of a financial instrument. Thus, a contract that requires settlement in cash or a variable number of the entity's own shares only on the occurrence of an event that is extremely rare, highly abnormal and very unlikely to occur is an equity instrument. Similarly, settlement in a fixed number of an entity's own shares may be contractually precluded in circumstances that are outside the control of the entity, but if these circumstances have no genuine possibility of occurring, classification as an equity instrument is appropriate.

Treatment in consolidated financial statements

AG28. In consolidated financial statements, an entity presents minority interests – i.e. the interests of other parties in the net assets and revenue of its controlled entities—in accordance with IPSAS 6, “Consolidated and Separate Financial Statements.” When classifying a financial instrument (or a component of it) in consolidated financial statements, an entity considers all terms and conditions agreed between members of the economic entity and the holders of the instrument in determining whether the economic as a whole has an obligation to deliver cash or another financial asset in respect of the instrument or to settle it in a manner that results in liability classification. When a controlled entity in an economic entity issues a financial instrument and a controlling entity or other entity agrees additional terms directly with the holders of the instrument (e.g. a guarantee), the economic entity may not have discretion over distributions or redemption. Although the controlled entity may appropriately classify the instrument without regard to these additional terms in its individual financial statements, the effect of other agreements between members of the economic entity and the holders of the instrument is considered in order to ensure that consolidated financial statements reflect the contracts and transactions entered into by the economic entity as a whole. To the extent that there is such an obligation or settlement provision, the instrument (or

the component of it that is subject to the obligation) is classified as a financial liability in consolidated financial statements.

Compound ~~F~~financial ~~I~~struments

A22:AG29. Paragraph ~~29~~–36of the Standard applies only to ~~issuers of non-derivative a limited group of compound instruments for the purpose of having the issuers present liability and equity instrument components separately on their statements of financial position.~~ Paragraph 36~~29~~ does not deal with compound financial instruments from the perspective of holders.

Amended as per IASB improvements project, ref IAS 32.AG29.

International and national accounting standards addressing the recognition and measurement of financial instruments deal with the separation of embedded derivatives from the perspective of holders of compound financial instruments that contain debt and net assets features.

A23:AG30. A common form of a compound financial instrument is a debt ~~security—instrument~~ with an embedded conversion option, such as a bond convertible into ~~common—ordinary~~ shares of the issuer, and without any other embedded derivative features. Paragraph 36~~29~~ of the Standard requires the issuer of such a financial instrument to present the liability component and the net assets/equity ~~instrument~~ component separately on the statement of financial position, ~~from their initial recognition, as follows:~~

Amended as per IASB improvements project, ref IAS 32.AG30.

- (a) The issuer's obligation to make scheduled payments of interest and principal ~~constitutes is~~ a financial liability ~~which—that~~ exists as long as the instrument is not converted. On ~~inception~~initial recognition, the fair value of the liability component is the present value of the contractually determined stream of future cash flows discounted at the rate of interest applied ~~by the market~~ at that time by the market to instruments of comparable credit status and providing substantially the same cash flows, on the same terms, but without the conversion option.
- (b) The equity instrument is an embedded option to convert the liability into net assets/equity of the issuer. The fair value of the option comprises its time value and its intrinsic value, if any. This option has value on initial recognition even when it is out of the money.~~The intrinsic value of an option or other derivative financial instrument is the excess, if any, of the fair value of the underlying financial instrument over the contractual price at which the underlying instrument is to be acquired, issued, sold or exchanged. The time value of a derivative instrument is its fair value less its intrinsic~~

~~value. The time value is associated with the length of the remaining term to maturity or expiry of the derivative instrument. It reflects the revenue foregone by the holder of the derivative instrument from not holding the underlying instrument, the cost avoided by the holder of the derivative instrument from not having to finance the underlying instrument and the value placed on the probability that the intrinsic value of the derivative instrument will increase prior to its maturity or expiry due to future volatility in the fair value of the underlying instrument. It is uncommon for the embedded option in a convertible bond or similar instrument to have any intrinsic value on issuance.~~

AG31. On conversion of a convertible instrument at maturity, the entity derecognizes the liability component and recognizes it as net assets. The original net assets component remains as net assets (although it may be transferred from one line item within net assets to another). There is no gain or loss on conversion at maturity.

Paragraphs
AG31 – AG36
inserted as per
IASB
improvements
project, ref IAS
32.AG31 –
AG36.

AG32. When an entity extinguishes a convertible instrument before maturity through an early redemption or repurchase in which the original conversion privileges are unchanged, the entity allocates the consideration paid and any transaction costs for the repurchase or redemption to the liability and net assets components of the instrument at the date of the transaction. The method used in allocating the consideration paid and transaction costs to the separate components is consistent with that used in the original allocation to the separate components of the proceeds received by the entity when the convertible instrument was issued, in accordance with paragraphs 36 to 41.

AG33. Once the allocation of the consideration is made, any resulting gain or loss is treated in accordance with accounting principles applicable to the related component, as follows:

- (a) The amount of gain or loss relating to the liability component is recognized in surplus or deficit.
- (b) The amount of consideration relating to the net assets component is recognized in net assets.

AG34. An entity may amend the terms of a convertible instrument to induce early conversion, for example by offering a more favorable conversion ratio or paying other additional consideration in the event of conversion before a specified date. The difference, at the date the terms are amended, between

the fair value of the consideration the holder receives on conversion of the instrument under the revised terms and the fair value of the consideration the holder would have received under the original terms is recognized as a loss in surplus or deficit.

Treasury shares

AG35. An entity's own equity instruments are not recognized as a financial asset regardless of the reason for which they are reacquired. Paragraph 42 requires an entity that reacquires its own equity instruments to deduct those equity instruments from net assets. However, when an entity holds its own net assets on behalf of others, e.g. a financial institution holding its own net assets on behalf of a client, there is an agency relationship and as a result those holdings are not included in the entity's statement of financial position.

Interest, dividends or similar distributions, losses and gains (see paragraphs 44 to 50)

AG36. The following example illustrates the application of paragraph 44 to a compound financial instrument. Assume that a non-cumulative preference share is mandatorily redeemable for cash in five years, but that dividends or similar distributions are payable at the discretion of the entity before the redemption date. Such an instrument is a compound financial instrument, with the liability component being the present value of the redemption amount. The unwinding of the discount on this component is recognized in surplus or deficit and classified as interest expense. Any dividends or similar distributions paid relate to the net assets component and, accordingly, are recognized as a distribution of surplus or deficit. A similar treatment would apply if the redemption was not mandatory but at the option of the holder, or if the share was mandatorily convertible into a variable number of ordinary shares calculated to equal a fixed amount or an amount based on changes in an underlying variable (e.g. commodity). However, if any unpaid dividends or similar distributions are added to the redemption amount, the entire instrument is a liability. In such a case, any dividends or similar distributions are classified as interest paid.

~~A24. Paragraph 34 of the Standard describes how the components of a compound financial instrument may be valued on initial recognition. The following example illustrates in greater detail how such valuations may be made.~~

Deleted as per
IASB
improvements
project.

~~An entity issues 2,000 convertible bonds at the start of Year 1. The bonds have a three-year term, and are issued at par with a face value of 1,000 per bond, giving total proceeds of 2,000,000. Interest is~~

~~payable annually in arrears at a nominal annual interest rate of 6%. Each bond is convertible at any time up to maturity into 250 common shares.~~

~~When the bonds are issued, the prevailing market interest rate for similar debt without conversion options is 9%. At the issue date, the market price of one common share is 3. The dividends expected over the three year term of the bonds amount to 0.14 per share at the end of each year. The risk-free annual interest rate for a three year term is 5%.~~

~~Residual Valuation of Equity Instrument Component:~~

~~Under this approach, the liability component is valued first, and the difference between the proceeds of the bond issue and the fair value of the liability is assigned to the net assets/equity component. The present value of the liability component is calculated using a discount rate of 9%, the market interest rate for similar bonds having no conversion rights, as shown.~~

Present value of the principal — 2,000,000	
payable at the end of three years	1,544,367
Present value of the interest — 120,000 payable	
annually in arrears for three years	<u>303,755</u>
Total liability component—	1,848,122
Equity instrument component (by deduction)	<u>151,878</u>
 Proceeds of the bond issue	 <u>2,000,000</u>

~~Option Pricing Model Valuation of Net Assets/Equity Component:~~

~~Option pricing models may be used to determine the fair value of conversion options directly rather than by deduction as illustrated above. Option pricing models are often used by financial institutions for pricing day-to-day transactions. There are a number of models available, of which the Black-Scholes model is one of the most well-known, and each has a number of variants. The following example illustrates the application of a version of the Black-Scholes model that utilizes tables available in finance textbooks and other sources. The steps in applying this version of the model are set out below.~~

~~This model first requires the calculation of two amounts that are used in the option valuation tables:~~

- ~~(a) Standard deviation of proportionate changes in the fair value of the asset underlying the option multiplied by the square root of the time to expiry of the option.~~

This amount relates to the potential for favorable (and unfavorable) changes in the price of the asset underlying the option, in this case the common shares of the entity issuing the convertible bonds. The volatility of the returns on the underlying asset are estimated by the standard deviation of the returns. The higher the standard deviation, the greater the fair value of the option. In this example, the standard deviation of the annual returns on the shares is assumed to be 30%. The time to expiry of the conversion rights is three years. The standard deviation of proportionate changes in fair value of the shares multiplied by the square root of the time to expiry of the option is thus determined as:

$$0.3 \times \sqrt{3} = \underline{0.5196}$$

- (b) Ratio of the fair value of the asset underlying the option to the present value of the option exercise price:

This amount relates the present value of the asset underlying the option to the cost that the option holder must pay to obtain that asset, and is associated with the intrinsic value of the option. The higher this amount, the greater the fair value of a call option. In this example, the market value of each share on issuance of the bonds is 3. The present value of the expected dividends over the term of the option is deducted from the market price, since the payment of dividends reduces the fair value of the shares and thus the fair value of the option. The present value of a dividend of 0.14 per share at the end of each year, discounted at the risk free rate of 5%, is 0.3813. The present value of the asset underlying the option is therefore:

$$3 - 0.3813 = 2.6187 \text{ per share}$$

The present value of the exercise price is 4 per share discounted at the risk free rate of 5% over three years, assuming that the bonds are converted at maturity, or 3.4554. The ratio is thus determined as:

$$2.6187 \div 3.4554 = \underline{0.7579}$$

The bond conversion option is a form of call option. The call option valuation table indicates that, for the two amounts calculated above (i.e., 0.5196 and 0.7579), the fair value of the option is approximately 11.05% of the fair value of the underlying asset.

The valuation of the conversion options can therefore be calculated as:

$$0.1105 \times 2.6187 \text{ per share} \times 250 \text{ shares per bond} \times 2,000 \text{ bonds} = \underline{144,683}$$

The fair value of the debt component of the compound instrument calculated above by the present value method plus the fair value of the

~~option calculated by the Black-Scholes option pricing model does not equal the 2,000,000 proceeds from issuance of the convertible bonds (i.e., 1,848,122 + 144,683 = 1,992,805). The small difference can be prorated over the fair values of the two components to produce a fair value for the liability of 1,854,794 and a fair value for the option of 145,206.~~

Offsetting of a ~~F~~financial ~~A~~asset and a ~~F~~financial ~~L~~iability

AG37. To offset a financial asset and a financial liability, an entity must have a currently enforceable legal right to set off the recognized amounts. An entity may have a conditional right to set off recognized amounts, such as in a master netting agreement or in some forms of non-recourse debt, but such rights are enforceable only on the occurrence of some future event, usually a default of the counterparty. Thus, such an arrangement does not meet the conditions for offset.

Inserted as per
IASB
improvements
project, ref IAS
32.AG37.

A25-AG38. The Standard does not provide special treatment for so-called “synthetic instruments,” which are groupings of separate financial instruments acquired and held to emulate the characteristics of another instrument. For example, a floating rate long-term debt combined with an interest rate swap that involves receiving floating payments and making fixed payments synthesizes a fixed rate long-term debt. Each of the ~~separate components of~~ individual financial instruments that together constitute a “synthetic instrument” represents a contractual right or obligation with its own terms and conditions and each may be transferred or settled separately. Each ~~component financial instrument~~ is exposed to risks that may differ from the risks to which other ~~components financial instruments~~ are exposed. Accordingly, when one ~~component financial instrument of in~~ a “synthetic instrument” is an asset and another is a liability, they are not offset and presented on an entity’s statement of financial position on a net basis unless they meet the criteria for offsetting in paragraph 51~~39~~ of the Standard. ~~Such is often not the case. Disclosures are provided about the significant terms and conditions of each financial instrument constituting a component of a “synthetic instrument” without regard to the existence of the “synthetic instrument,” although an entity may indicate the nature of the relationship between the components (see paragraph 58 of the Standard).~~

Amended as per
IASB
improvements
project, ref IAS
32.AG38.

Disclosure

~~A26. Paragraph 60 of the Standard lists examples of broad categories of matters that, when significant, an entity~~

Paragraphs A26
– A27 deleted as
per IASB
improvements
project.

~~addresses in its disclosure of accounting policies. In each case, an entity has a choice from among two or more different accounting treatments. The following discussion elaborates on the examples in paragraph 60 and provides further examples of circumstances in which an entity discloses its accounting policies:~~

- ~~(a) An entity may acquire or issue a financial instrument under which the obligations of each party are partially or completely unperformed (sometimes referred to as an unexecuted or executory contract). Such a financial instrument may involve a future exchange and performance may be conditional on a future event. For example, neither the right nor the obligation to make an exchange under a forward contract results in any transaction in the underlying financial instrument until the maturity of the contract but the right and obligation constitute a financial asset and a financial liability, respectively. Similarly, a financial guarantee does not require the guarantor to assume any obligation to the holder of the guaranteed debt until an event of default has occurred. The guarantee is, however, a financial liability of the guarantor because it is a contractual obligation to exchange one financial instrument (usually cash) for another (a receivable from the defaulted debtor) under conditions that are potentially unfavorable.~~
- ~~(b) An entity may undertake a transaction that, in form, constitutes a direct acquisition or disposition of a financial instrument but does not involve the transfer of the economic interest in it. Such is the case with some types of repurchase and reverse repurchase agreements. Conversely, an entity may acquire or transfer to another party an economic interest in a financial instrument through a transaction that, in form, does not involve an acquisition or disposition of legal title. For example, in a non-recourse borrowing, an entity may pledge accounts receivable as collateral and agree to use receipts from the pledged accounts solely to service the loan.~~
- ~~(c) An entity may undertake a partial or incomplete transfer of a financial asset. For example, in a securitization, an entity acquires or transfers to another party some, but not all, of the future economic benefits associated with a financial instrument.~~
- ~~(d) An entity may be required, or intend, to link two or more individual financial instruments to provide specific assets to satisfy specific obligations. Such arrangements include, for example, “in substance” defeasance trusts in which financial assets are set aside for the purpose of discharging an obligation without those assets having been accepted by the creditor in settlement of the obligation, non-recourse secured financing and sinking fund arrangements.~~

- ~~(e) An entity may use various risk management techniques to minimize exposures to financial risks. Such techniques include, for example, hedging, interest rate conversion from floating rate to fixed rate or fixed rate to floating rate, risk diversification, risk pooling, guarantees and various types of insurance (including sureties and “hold harmless” agreements). These techniques generally reduce the exposure to loss from only one of several different financial risks associated with a financial instrument and involve the assumption of additional but only partially offsetting risk exposures.~~
- ~~(f) An entity may link two or more separate financial instruments together notionally in a “synthetic instrument” or for some purposes other than those described in items (d) and (e) above.~~
- ~~(g) An entity may acquire or issue a financial instrument in a transaction in which the amount of the consideration exchanged for the instrument is uncertain. Such transactions may involve non-cash consideration or an exchange of several items.~~
- ~~(h) An entity may acquire or issue a bond, promissory note or other monetary instrument with a stated amount or rate of interest that differs from the prevailing market interest rate applicable to the instrument. Such financial instruments include zero coupon bonds and loans made on apparently favorable terms but involving non-cash consideration, for example, low interest rate loans to employees.~~

~~A27. Paragraph 61 of the Standard lists several issues that an entity addresses in its disclosure of accounting policies when the issues are significant to the application of the cost basis of measurement. In the case of uncertainty about the collectibility of amounts realizable from a monetary financial asset or a decline in the fair value of a financial asset below its carrying amount due to other causes, an entity indicates its policies for determining:~~

- ~~(a) When to reduce the carrying amount of the asset;~~
- ~~(b) The amount to which it reduces the carrying amount;~~
- ~~(c) How to recognize any revenue from the asset; and~~
- ~~(d) Whether the reduction in carrying amount may be reversed in the future if circumstances change.~~

Appendix 2

Amendments to Other IPSASs

The amendments in this appendix shall be applied for annual periods beginning on or after Month XX, YYYY. If an entity applies the IPSAS for an earlier period, these amendments shall be applied for that earlier period. In the amended paragraphs, new text is underlined and deleted text is struck through.

A1. In International Public Sector Accounting Standards, references to IPSAS 15, “Financial Instruments: Disclosure and Presentation” are replaced by references to IPSAS 15, “Financial Instruments: Presentation”, unless otherwise stated below.

A2. IPSAS 1, “Presentation of Financial Statements” is amended as described below:

In paragraph 75, the sentence ‘IPSAS 15, “Financial Instruments: Disclosure and Presentation” requires disclosure of the maturity dates of financial assets and financial liabilities’ is deleted.

In paragraph 129(d)(ii) the reference to IPSAS 15 is deleted.

In paragraph 148, the sentence referring to IPSAS 15 is deleted.

Appendix 2 inserted as per IASB improvements project to update existing IPSASs. Many of the amendments made by the IASB are not relevant to IPSASs, therefore this appendix has fewer amendments than its IASB equivalent.

Appendix 13

Implementation Guide

This appendix is illustrative only and does not form part of the ~~standards~~ Standard. The purpose of this appendix is to assist preparers of financial statements in identifying those aspects of the Standard that apply to them.

This implementation guide should be read jointly in conjunction with the Standard. Readers are cautioned that the flowcharts and text included in this Guide provide only a broad overview of the requirements of the Standard.

Requirements of IPSAS 15 — Overview

All entities will need to review scope paragraphs ~~34–138~~ and consult the definition of a financial instrument and related commentary (paragraphs ~~9v21–14–17~~) to determine when the Standard is applicable and whether they hold financial instruments.

This appendix has been amended to make its terminology consistent with other IPSASs, to remove references to disclosures, to update paragraph references and to update the scope of the IPSAS.

~~The relevant paragraphs in the Standard for entities with only financial assets are paragraphs 48–101 (Disclosure).~~

The relevant paragraphs in the Standard for entities with *only* financial liabilities are paragraphs ~~1822–3528~~ and ~~3936–4138 (Presentation)~~, and ~~paragraphs 48–72, 84–94 and 98–101 (Disclosure).~~

The relevant paragraphs in the Standard for entities with *only* equity instruments are paragraphs ~~2522–3128~~ and ~~3936–4138 (Presentation)~~, and ~~paragraphs 50–62 and 98–101 (Disclosure).~~

Where entities hold both financial assets and financial liabilities, additional relevant paragraphs are ~~4239–5047 (Presentation).~~

Where entities hold both financial liabilities and net assets/equity, additional relevant paragraphs are ~~3229–3835 (Presentation).~~

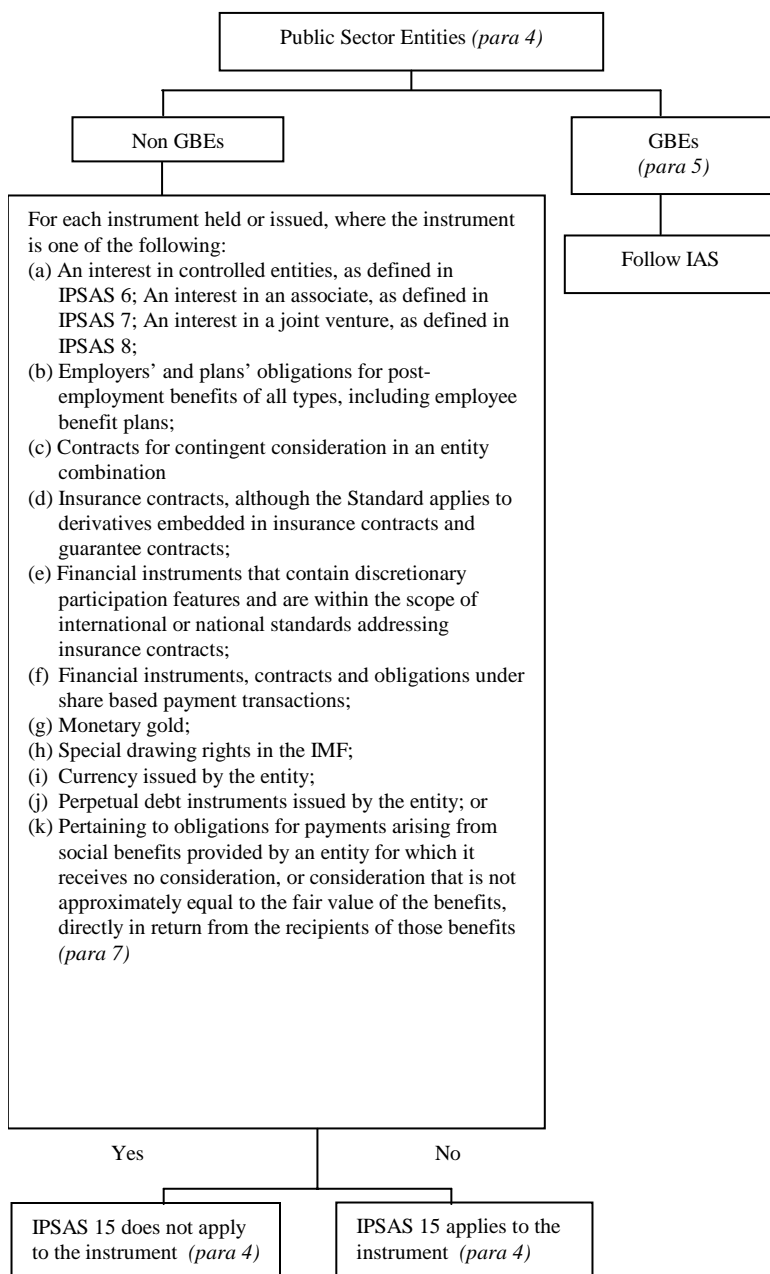
The relevant paragraphs in the Standard for entities that reacquire their own equity instruments are paragraphs 42–43.

Comparative information is required for all instruments (see IPSAS 1, “Presentation of Financial Statements,” ~~paragraphs 60–63~~) except, if not available, during the year of first adoption ~~(paragraph 102).~~

*Summary of Standard ~~A~~pplicability, ~~—~~ ~~and~~ ~~P~~resentation ~~and~~ ~~D~~isclosure
~~Requirements~~ requirements*

This section provides an overview of the requirements in respect of financial assets, financial liabilities and equity instruments. The following flowcharts identify key black letter paragraphs of the Standard.

Scope of the Standard

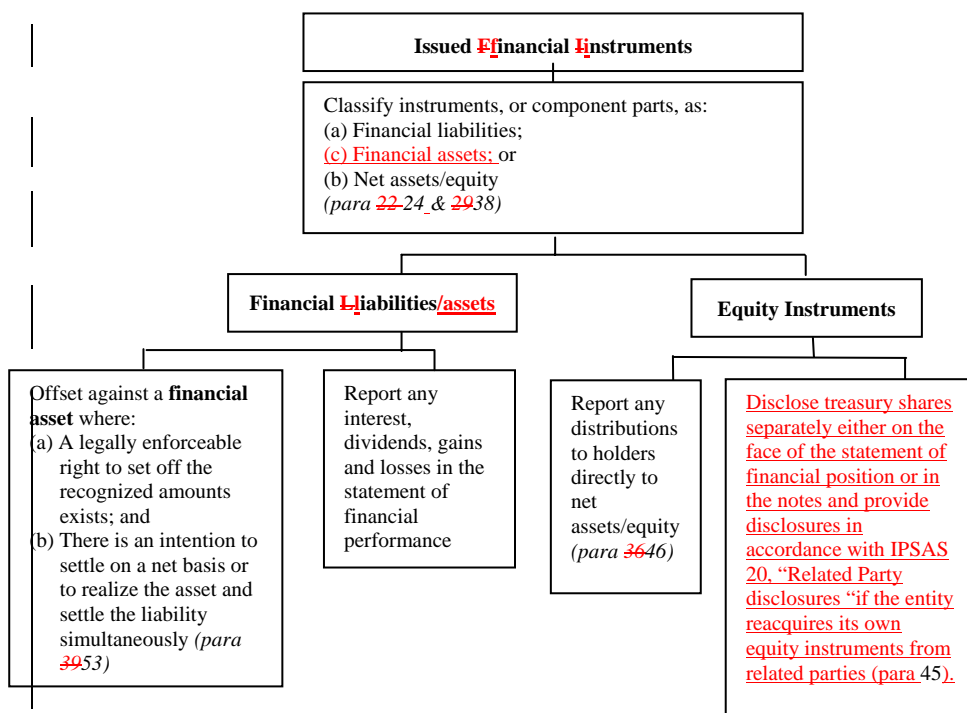


Scope

Staff are of the view that this paragraph is repetitious of paragraphs 5 – 7 and is unnecessary

~~This Standard applies to public sector entities reporting under the accrual basis of accounting. Government Business Enterprises (GBEs) are excluded from the scope of these IPSASs (paragraph 2), however, the “Preface to International Public Sector Accounting Standards” explains that GBEs apply with IFRSs. This IPSAS also exempts financial instruments of the types identified in paragraph 4 of the Standard from having to comply with the disclosure and presentation rules set out within the Standard. Commentary on these excluded financial instruments can be found in paragraphs 5–8.~~

Presentation — Issued Financial Instruments



This Standard sets out the requirements for the presentation of financial instruments. Financial instruments can be classified as being financial assets, financial liabilities or equity instruments. These terms are defined in paragraph 9–14 of the Standard. Additional discussion clarifying these defined terms and what constitutes a financial instrument is located in commentary paragraphs 1015–217. Examples of financial instruments covered by the Standard are included in Appendix 21, paragraphs AG3A3–AG23A16. Appendix 3 contains illustrative examples for the application of paragraphs 18 to 35.

Classification

The Standard requires that the issuer of a financial instrument classify the instrument, or its component parts, on initial recognition, as a financial liability, financial asset or as ~~net assets~~ an equity instrument (see paragraph 2221). Commentary in paragraphs 2322–28–34 provides users with guidance in distinguishing the nature of the instrument to facilitate consistency in classification across users. Appendix 21, paragraphs AG18–AG21, provides examples of instruments which should be classified as liabilities or as net assets/equity.

Amended as per IASB improvements project (note IAS 32 does not include this appendix).

It is likely that few public sector entities will issue compound financial instruments (see paragraph 3036). The Standard requires that where such financial instruments are issued, the financial liability, financial liability and net assets/equity components should be separately classified ~~and disclosed~~ (see paragraph 2935). Commentary paragraphs 3437–33–38 and Appendix 21, paragraphs AQ22 and AQ23, discuss various instances where separate classification is necessary. Paragraphs 3439 and 3540 set out two methods by which preparers could assign a carrying amount to the various components, ~~and Appendix 2, paragraph A24 illustrates an example of how to assign values to the elements.~~

Treasury shares

The Standard incorporates guidance on the acquisition or subsequent resale by an entity of its own equity instruments in paragraphs 41–42. appendix 1, paragraph AG35 notes that an entity's own equity instruments are not recognized as a financial asset regardless of the reason for which they were acquired.

Amended as per IASB improvements project (note IAS 32 does not include this appendix).

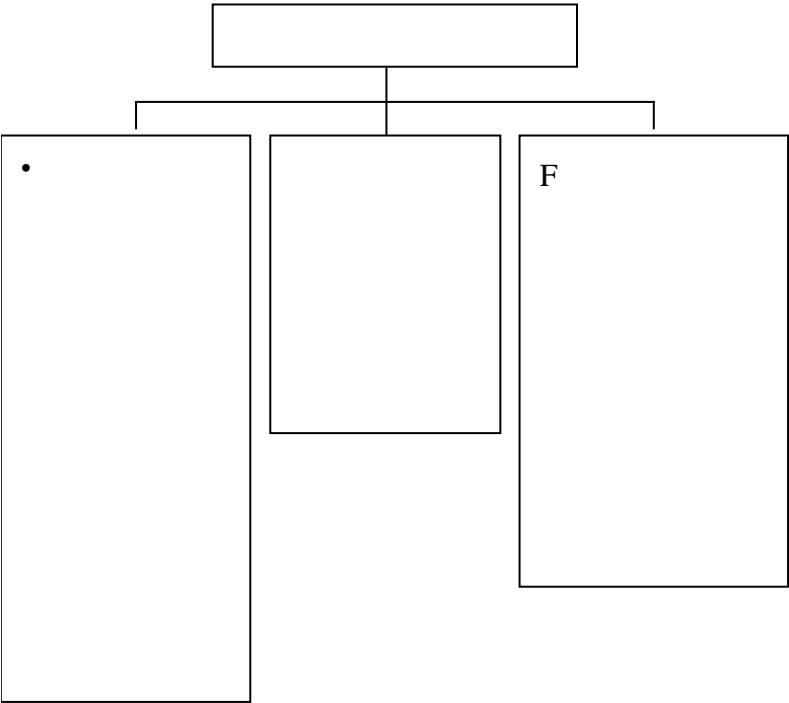
Interest, Dividends and Similar Distributions, Losses and Gains

The Standard sets out when such items should be classified as revenue or expense, or as a direct debit to net assets/equity (see paragraph 3643). Further guidance and clarifying comments made regarding these classifications is located within paragraphs 3744 and 3848.

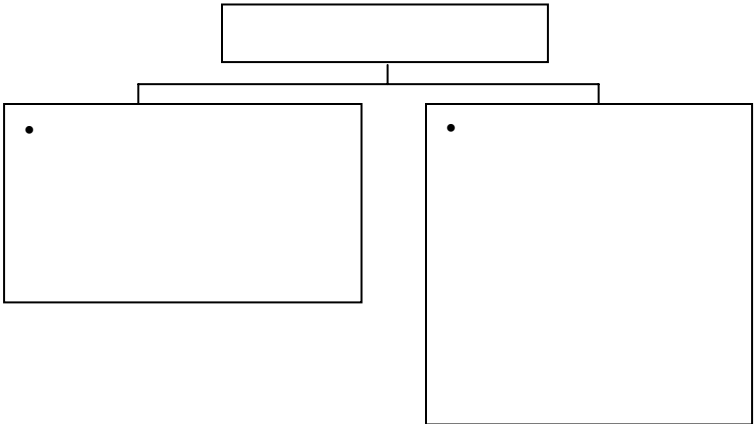
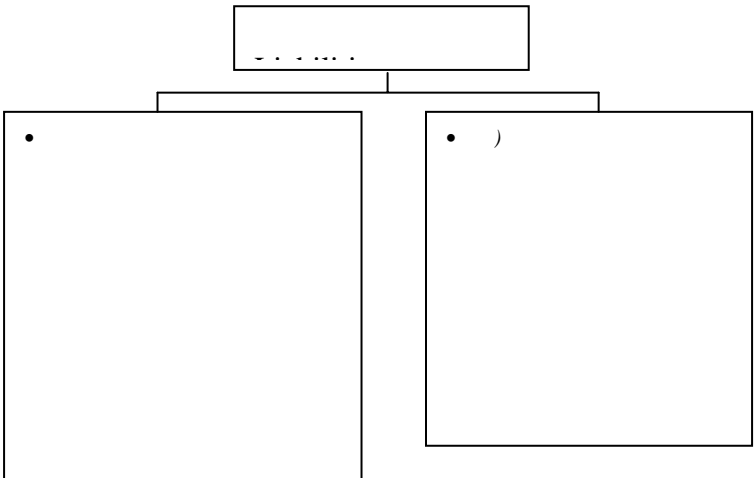
Offsetting

The Standard prescribes when an entity should offset a financial asset and a financial liability in the statement of financial position (see paragraph 3950). Subsequent commentary includes an explanation of the difference between offsetting instruments and ceasing to recognize an instrument (see paragraph 4152), a discussion of the conditions necessary before an offset is allowable (paragraphs 4253–4556), and provides examples of situations where offsetting would not be allowable (paragraphs 5846 and 5947). Paragraph 5240 provides an example of where instruments should be offset, noting that in other circumstances, separate presentation consistent with the instrument's characteristics as an asset or liability is appropriate. Appendix 2, paragraph AG38A25, notes that "synthetic instruments" with financial asset and financial liability components should not be offset unless they meet the criteria for offsetting detailed in paragraph 5139.

~~Further discussion pertaining to offsetting and disclosures warranted in those instances is located within paragraphs 77, 78 and 94 of the Standard.~~



Deleted as per IASB improvements project (note IAS 32 does not include this appendix).



Deleted as per
IASB
improvements
project (note IAS
32 does not
include this
appendix).

~~A comprehensive example of the disclosures required of financial instruments under this Standard appears in Appendix 3.~~

~~*Risk*~~

~~A discussion on various forms of risk associated with financial instruments is located in paragraph 49 of the Standard. While the Standard requires disclosure of risk management objectives and policies (paragraph 50), the associated commentary paragraphs 51–53 indicate that aside from the specific inclusion required under paragraph 50, the format, location and level of detail is subject to management's judgement.~~

~~*Terms, Conditions and Accounting Policies*~~

~~The Standard requires disclosure of the extent and nature of financial instruments, and the accounting policies and methods employed (paragraph 54). Commentary paragraphs 55–62, and Appendix 2, paragraphs A26 and A27, provide guidance on the types of information that may be appropriate and instances where disclosure of information is warranted.~~

~~*Interest Rate Risk*~~

~~The reasons for the disclosures about interest rate risk exposure required by paragraph 63 and guidance on the types of information that should be disclosed is located in commentary paragraphs 64–70. Guidance on the presentation of this information is presented in paragraphs 71 and 72.~~

~~*Credit Risk*~~

~~The reasons for the disclosures about credit risk information for the financial assets of the entity is located at paragraph 74 and 75 of the Standard. Commentary paragraphs 76–83 provide readers with examples and discussion of instances where additional credit risk information is desirable or warranted.~~

Deleted as per
IASB
improvements
project (note IAS
32 does not
include this
appendix).

~~*Fair Value*~~

~~Paragraph 85 explains why the Standard requires the disclosure of fair value information. Discussion regarding the determination of a fair value amount is located at paragraphs 86–91, and at paragraph 93 of the Standard.~~

~~Paragraph 84 of the Standard provides preparers with relief from having to disclose fair value information for each class of financial asset and financial liability where it is not practicable with regard to time or cost. Discussion regarding this relief, and the information to be disclosed is found in commentary paragraph 92.~~

~~Where classes of financial assets or financial liabilities are carried at other than at their fair value, paragraph 94 notes that information should be provided in a manner that permits comparison between the carrying value and the fair value.~~

Financial Assets Carried at an Amount in Excess of Fair Value

~~In some instances, management decides not to write down the carrying amount of financial assets to their fair value. Paragraph 95 requires certain disclosures to be made when this occurs. Paragraph 96 and 97 provide discussion of the issue.~~

Hedges of Anticipated Future Transactions

~~Paragraph 98 requires certain disclosures to be made in respect of financial instruments used for hedging risks related to an anticipated future transaction. Paragraph 99 explains why these disclosures are important. It also explains when such information may be provided on an aggregate basis. Paragraph 100 clarifies the types of items that would be included within paragraph 98(c) pertaining to the disclosure of any deferred or unrecognized gain or loss.~~

Deleted as per IASB improvements project (note IAS 32 does not include this appendix).

Other Disclosure

~~The Standard encourages preparers to disclose information that would be expected to enhance users' understanding of financial instruments. Examples of such disclosures are included in paragraph 101.~~

This Appendix is new and has been adapted from the similar appendix in IAS 32.

Appendix 34

Illustrative Examples

The appendix is illustrative only and does not form part of the Standard. The purpose of the appendix is to illustrate the application of the Standard to assist in clarifying its meaning in a number of situations.

Accounting for contracts on equity instruments of an entity

IE1. The following examples illustrate the application of paragraphs 18 to 31 of this Standard. The examples assume that the entity has adopted accounting policies for the recognition and measurement of financial instruments that are consistent with International Financial Reporting Standard, IAS 39, “Financial Instruments: Recognition and Measurement”.

Example 1: Forward to buy shares

IE2. This example illustrates the journal entries for forward purchase contracts on an entity’s own shares that will be settled (a) net in cash, (b) net in shares or (c) by delivering cash in exchange for shares. It also discusses the effect of settlement options (see (d) below). To simplify the illustration, it is assumed that no dividends or similar distributions are paid on the underlying shares (i.e. the ‘carry return’ is zero) so that the present value of the forward price equals the spot price when the fair value of the forward contract is zero. The fair value of the forward has been computed as the difference between the market share price and the present value of the fixed forward price.

Assumptions:

<u>Contract date</u>	<u>February 1, 20X2</u>
<u>Maturity date</u>	<u>January 31, 20X3</u>
<u>Market price per share on February 1, 20X2</u>	<u>CU100</u>
<u>Market price per share on December 31, 20X2</u>	<u>CU110</u>
<u>Market price per share on January 31, 20X3</u>	<u>CU106</u>
<u>Fixed forward price to be paid on January 31, 20X3</u>	<u>CU104</u>

<u>Present value of forward price on February 1, 20X2</u>	<u>CU100</u>
<u>Number of shares under forward contract</u>	<u>1,000</u>
<u>Fair value of forward on February 1, 20X2</u>	<u>CU0</u>
<u>Fair value of forward on December 31, 20X2</u>	<u>CU6,300</u>
<u>Fair value of forward on January 31, 20X3</u>	<u>CU2,000</u>

(a) Cash for cash ('net cash settlement')

IE3. In this subsection, the forward purchase contract on the entity's own shares will be settled net in cash, i.e. there is no receipt or delivery of the entity's own shares upon settlement of the forward contract.

On February 1, 20X2, Entity A enters into a contract with Entity B to receive the fair value of 1,000 of Entity A's own outstanding ordinary shares as of January 31, 20X4 in exchange for a payment of R104,000 in cash (i.e. CU104 per share) on January 31, 20X4. The contract will be settled net in cash. Entity A records the following journal entries:

February 1, 20X2

The price per share when the contract is agreed on February 1, 20X2 is CU100. The initial fair value of the forward contract on February 1, 20X2 is zero.

No entry is required because the fair value of the derivative is zero and no cash is paid or received.

December 31, 20X3

On December 31, 20X3, the market price per share has increased to CU110 and, as a result, the fair value of the forward contract has increased to CU6,300.

<u>Dr Forward asset</u>	<u>CU6,300</u>
<u> Cr Gain</u>	<u>CU6,300</u>

To record the increase in the fair value of the forward contract.

January 31, 20X4

On January 31, 20X4, the market price per share has decreased to CU106. The fair value of the forward contract is CU2,000 ($[\text{CU}106 \times 1,000] - \text{CU}104,000$). On the same day, the contract is settled net in cash. Entity A has an obligation to deliver CU104,000 to Entity B and Entity B has an obligation to deliver CU106,000 ($\text{CU}106 \times 1,000$) to Entity A, so Entity B pays the net amount of CU2,000 to Entity A.

<u>Dr Loss</u>	<u>CU4,300</u>
<u> Cr Forward asset</u>	<u>CU4,300</u>

To record the decrease in the fair value of the forward contract (i.e. $CU4,300 = CU6,300 - CU2,000$).

Dr Cash	CU2,000
Cr Forward asset	CU2,000

To record the settlement of the forward contract.

(b) Shares for shares ('net share settlement')

IE4. Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. Entity A's journal entries are the same as those shown in (a) above, except for recording the settlement of the forward contract, as follows:

January 31, 20X4

The contract is settled net in shares. Entity A has an obligation to deliver CU104,000 ($CU104 \times 1,000$) worth of its shares to Entity B and Entity B has an obligation to deliver CU106,000 ($CU106 \times 1,000$) worth of shares to Entity A. Thus, Entity B delivers a net amount of CU2,000 ($CU106,000 - CU104,000$) worth of shares to Entity A, i.e. 18.9 shares ($CU2,000/CU106$).

Dr Net assets	CU2,000
Cr Forward asset	CU2,000

To record the settlement of the forward contract.

(c) Cash for shares ('gross physical settlement')

IE5. Assume the same facts as in (a) except that settlement will be made by delivering a fixed amount of cash and receiving a fixed number of Entity A's shares. Similarly to (a) and (b) above, the price per share that Entity A will pay in one year is fixed at CU104. Accordingly, Entity A has an obligation to pay CU104,000 in cash to Entity B ($CU104 \times 1,000$) and Entity B has an obligation to deliver 1,000 of Entity A's outstanding shares to Entity A in one year. Entity A records the following journal entries.

February 1, 20X2

Dr Net assets	CU100,000
Cr Liability	CU100,000

To record the obligation to deliver CU104,000 in one year at its present value of CU100,000 discounted using an appropriate interest rate.

December 31, 20X3

Dr Interest expense	CU3,660
Cr Liability	CU3,660

To accrue interest in accordance with the effective interest method on the liability for the share redemption amount.

January 31, 20X4

Dr Interest expense	CU340
Cr Liability	CU340

To accrue interest in accordance with the effective interest method on the liability for the share redemption amount.

Entity A delivers CU104,000 in cash to Entity B and Entity B delivers 1,000 of Entity A's shares to Entity A.

Dr Liability	CU104,000
Cr Cash	CU104,000

To record the settlement of the obligation to redeem Entity A's own shares for cash.

(d) Settlement options

IE6. The existence of settlement options (such as net in cash, net in shares or by an exchange of cash and shares) has the result that the forward repurchase contract is a financial asset or a financial liability. If one of the settlement alternatives is to exchange cash for shares ((c) above), Entity A recognizes a liability for the obligation to deliver cash, as illustrated in (c) above. Otherwise, Entity A accounts for the forward contract as a derivative.

Example 2: Forward to sell shares

IE7. This example illustrates the journal entries for forward sale contracts on an entity's own shares that will be settled (a) net in cash, (b) net in shares or (c) by receiving cash in exchange for shares. It also discusses the effect of settlement options (see (d) below). To simplify the illustration, it is assumed

that no dividends or similar distributions are paid on the underlying shares (i.e. the 'carry return' is zero) so that the present value of the forward price equals the spot price when the fair value of the forward contract is zero. The fair value of the forward has been computed as the difference between the market share price and the present value of the fixed forward price.

Assumptions:

<u>Contract date</u>	<u>February 1, 20X2</u>
<u>Maturity date</u>	<u>January 31, 20X4</u>
<u>Market price per share on February 1, 20X2</u>	<u>CU100</u>
<u>Market price per share on December 31, 20X3</u>	<u>CU110</u>
<u>Market price per share on January 31, 20X4</u>	<u>CU106</u>
<u>Fixed forward price to be paid on January 31, 20X4</u>	<u>CU104</u>
<u>Present value of forward price on February 1, 20X2</u>	<u>CU100</u>
<u>Number of shares under forward contract</u>	<u>1,000</u>
<u>Fair value of forward on February 1, 20X2</u>	<u>CU0</u>
<u>Fair value of forward on December 31, 20X3</u>	<u>(CU6,300)</u>
<u>Fair value of forward on January 31, 20X4</u>	<u>(CU2,000)</u>

(a) Cash for cash ('net cash settlement')

IE8. On February 1, 20X2, Entity A enters into a contract with Entity B to pay the fair value of 1,000 of Entity A's own outstanding ordinary shares as of January 31, 20X4 in exchange for CU104,000 in cash (i.e. CU104 per share) on January 31, 20X4. The contract will be settled net in cash. Entity A records the following journal entries.

February 1, 20X2

No entry is required because the fair value of the derivative is zero and no cash is paid or received.

December 31, 20X3

<u>Dr Loss</u>	<u>CU3,600</u>
<u>Cr Forward liability</u>	<u>CU3,600</u>

To record the decrease in the fair value of the forward contract.

January 31, 20X4

<u>Dr Forward liability</u>	<u>CU4,300</u>
-----------------------------	----------------

Cr Gain CU4,300

To record the increase in the fair value of the forward contract (i.e. $CU4,300 = CU6,300 - CU2,000$).

The contract is settled net in cash. Entity B has an obligation to deliver CU104,000 to Entity A, and Entity A has an obligation to deliver CU106,000 ($CU106 \times 1,000$) to Entity B. Thus, Entity A pays the net amount of CU2,000 to Entity B.

Dr Forward liability CU2,000

Cr Cash CU2,000

To record the settlement of the forward contract.

(b) Shares for shares ('net share settlement')

IE9. Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. Entity A's journal entries are the same as those shown in (a), except:

January 31, 20X4

The contract is settled net in shares. Entity A has a right to receive CU104,000 ($CU104 \times 1,000$) worth of its shares and an obligation to deliver CU106,000 ($CU106 \times 1,000$) worth of its shares to Entity B. Thus, Entity A delivers a net amount of CU2,000 ($CU106,000 - CU104,000$) worth of its shares to Entity B, i.e. 18.9 shares ($CU2,000/CU106$).

Dr Financial liability CU2,000

Cr Net assets CU2,000

To record the settlement of the forward contract. The issue of the entity's own shares is treated as a net assets transaction.

(c) Shares for cash ('gross physical settlement')

IE10. Assume the same facts as in (a), except that settlement will be made by receiving a fixed amount of cash and delivering a fixed number of the entity's own shares. Similarly to (a) and (b) above, the price per share that Entity A will pay in one year is fixed at CU104. Accordingly, Entity A has a right to receive CU104,000 in cash ($CU104 \times 1,000$) and an obligation to deliver 1,000 of its own shares in one year. Entity A records the following journal entries.

February 1, 20X2

No entry is made on February 1, 20X2. No cash is paid or received because the forward has an initial fair value of zero. A forward contract to deliver a fixed

number of Entity A's own shares in exchange for a fixed amount of cash or another financial asset meets the definition of an equity instrument because it cannot be settled otherwise than through the delivery of shares in exchange for cash.

December 31, 20X3

No entry is made on December 31, 20X3 because no cash is paid or received and a contract to deliver a fixed number of Entity A's own shares in exchange for a fixed amount of cash meets the definition of an equity instrument of the entity.

January 31, 20X4

On January 31, 20X4, Entity A receives CU104,000 in cash and delivers 1,000 shares.

<u>Dr Cash</u>	<u>CU104,000</u>
<u>Cr Net assets</u>	<u>CU104,000</u>

To record the settlement of the forward contract.

(d) Settlement options

IE11. The existence of settlement options (such as net in cash, net in shares or by an exchange of cash and shares) has the result that the forward contract is a financial asset or a financial liability. It does not meet the definition of an equity instrument because it can be settled otherwise than by Entity A repurchasing a fixed number of its own shares in exchange for paying a fixed amount of cash or another financial asset. Entity A recognizes a derivative asset or liability, as illustrated in (a) and (b) above. The accounting entry to be made on settlement depends on how the contract is actually settled.

Example 3: Purchased call option on shares

IE12. This example illustrates the journal entries for a purchased call option right on the entity's own shares that will be settled (a) net in cash, (b) net in shares or (c) by delivering cash in exchange for the entity's own shares. It also discusses the effect of settlement options (see (d) below):

Assumptions:

<u>Contract date</u>	<u>February 1, 20X2</u>
<u>Exercise date</u>	<u>January 31, 20X4</u>
<u>(European terms, i.e. it can be exercised only at maturity)</u>	<u>Reporting entity</u>
<u>Exercise right holder</u>	

(Entity A)

<u>Market price per share on February 1, 20X2</u>	<u>CU100</u>
<u>Market price per share on December 31, 20X3</u>	<u>CU104</u>
<u>Market price per share on January 31, 20X4</u>	<u>CU104</u>
<u>Fixed exercise price to be paid on January 31, 20X4</u>	<u>CU102</u>
<u>Number of shares under option contract</u>	<u>1,000</u>
<u>Fair value of option on February 1, 20X2</u>	<u>CU5,000</u>
<u>Fair value of option on December 31, 20X3</u>	<u>CU3,000</u>
<u>Fair value of option on January 31, 20X4</u>	<u>CU2,000</u>

(a) Cash for cash ('net cash settlement')

IE13. On February 1, 20X2, Entity A enters into a contract with Entity B that gives Entity B the obligation to deliver, and Entity A the right to receive the fair value of 1,000 of Entity A's own ordinary shares as of January 31, 20X4 in exchange for CU102,000 in cash (i.e. CU102 per share) on January 31, 20X4, if Entity A exercises that right. The contract will be settled net in cash. If Entity A does not exercise its right, no payment will be made. Entity A records the following journal entries:

February 1, 20X2

The price per share when the contract is agreed on February 1, 20X2 is CU100. The initial fair value of the option contract on February 1, 20X2 is CU5,000, which Entity A pays to Entity B in cash on that date. On that date, the option has no intrinsic value, only time value, because the exercise price of CU102 exceeds the market price per share of CU100 and it would therefore not be economic for Entity A to exercise the option. In other words, the call option is out of the money.

<u>Dr Call option asset</u>	<u>CU5,000</u>
<u> Cr Cash</u>	<u>CU5,000</u>

To recognize the purchased call option.

December 31, 20X3

On December 31, 20X3, the market price per share has increased to CU104. The fair value of the call option has decreased to CU3,000, of which CU2,000 is intrinsic value ($(CU104 - CU102) \times 1,000$), and CU1,000 is the remaining time value.

Dr Loss	CU2,000
Cr Call option asset	CU2,000

To record the decrease in the fair value of the call option.

January 31, 20X4

On January 31, 20X4, the market price per share is still CU104. The fair value of the call option has decreased to CU2,000, which is all intrinsic value ($(CU104 - CU102) \times 1,000$) because no time value remains.

Dr Loss	CU1,000
Cr Call option asset	CU1,000

To record the decrease in the fair value of the call option.

On the same day, Entity A exercises the call option and the contract is settled net in cash. Entity B has an obligation to deliver CU104,000 ($CU104 \times 1,000$) to Entity A in exchange for CU102,000 ($CU102 \times 1,000$) from Entity A, so Entity A receives a net amount of CU2,000.

Dr Cash	CU2,000
Cr Call option asset	CU2,000

To record the settlement of the option contract.

(b) Shares for shares ('net share settlement')

IE14. Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. Entity A's journal entries are the same as those shown in (a) except for recording the settlement of the option contract as follows:

January 31, 20X4

Entity A exercises the call option and the contract is settled net in shares. Entity B has an obligation to deliver CU104,000 ($CU104 \times 1,000$) worth of Entity A's shares to Entity A in exchange for CU102,000 ($CU102 \times 1,000$) worth of Entity A's shares. Thus, Entity B delivers the net amount of CU2,000 worth of shares to Entity A, i.e. 19.2 shares ($CU2,000/CU104$).

Dr Net assets	CU2,000
Cr Call option asset	CU2,000

To record the settlement of the option contract. The settlement is accounted for as a treasury share transaction (i.e. no gain or loss).

(c) Cash for shares ('gross physical settlement')

IE15. Assume the same facts as in (a) except that settlement will be made by receiving a fixed number of shares and paying a fixed amount of cash, if Entity A exercises the option. Similarly to (a) and (b) above, the exercise price per share is fixed at CU102. Accordingly, Entity A has a right to receive 1,000 of Entity A's own outstanding shares in exchange for CU102,000 (CU102 × 1,000) in cash, if Entity A exercises its option. Entity A records the following journal entries.

February 1, 20X2

Dr Net assets	CU5,000
Cr Cash	CU5,000

To record the cash paid in exchange for the right to receive Entity A's own shares in one year for a fixed price. The premium paid is recognized in net assets.

December 31, 20X3

No entry is made on December 31, 20X3 because no cash is paid or received and a contract that gives a right to receive a fixed number of Entity A's own shares in exchange for a fixed amount of cash meets the definition of an equity instrument of the entity.

January 31, 20X4

Entity A exercises the call option and the contract is settled gross. Entity B has an obligation to deliver 1,000 of Entity A's shares in exchange for CU102,000 in cash.

Dr Net assets	CU102,000
Cr Cash	CU102,000

To record the settlement of the option contract.

(d) Settlement options

IE16. The existence of settlement options (such as net in cash, net in shares or by an exchange of cash and shares) has the result that the call option is a financial asset. It does not meet the definition of an equity instrument because it can be settled otherwise than by Entity A repurchasing a fixed number of its own shares in exchange for paying a fixed amount of cash or another financial asset. Entity A recognizes a derivative asset, as illustrated

in (a) and (b) above. The accounting entry to be made on settlement depends on how the contract is actually settled.

Example 4: Written call option on shares

IE17. This example illustrates the journal entries for a written call option obligation on the entity's own shares that will be settled (a) net in cash, (b) net in shares or (c) by delivering cash in exchange for shares. It also discusses the effect of settlement options (see (d) below).

Assumptions:

Contract date February 1, 20X2

Exercise date January 31, 20X3

(European terms, i.e. it can be exercised only at maturity)

Exercise right holder Counterpart (Entity B)

Market price per share on February 1, 20X2 CU100

Market price per share on December 31, 20X3 CU104

Market price per share on January 31, 20X4 CU104

Fixed exercise price to be paid on January 31, 20X4 CU102

Number of shares under option contract 1,000

Fair value of option on February 1, 20X2 CU5,000

Fair value of option on December 31, 20X3 CU3,000

Fair value of option on January 31, 20X4 CU2,000

(a) Cash for cash ('net cash settlement')

IE18. Assume the same facts as in Example 3(a) above except that Entity A has written a call option on its own shares instead of having purchased a call option on them. Accordingly, on February 1, 20X2 Entity A enters into a contract with Entity B that gives Entity B the right to receive and Entity A the obligation to pay the fair value of 1,000 of Entity A's own ordinary shares as of January 31, 20X3 in exchange for CU102,000 in cash (i.e. CU102 per share) on January 31, 20X3, if Entity B exercises that right. The contract will be settled net in cash. If Entity B does not exercise its right, no payment will be made. Entity A records the following journal entries.

February 1, 20X2

Dr Cash	CU5,000
Cr Call option obligation	CU5,000

To recognize the written call option.

December 31, 20X3

Dr Call option obligation	CU2,000
Cr Gain	CU2,000

To record the decrease in the fair value of the call option.

January 31, 20X4

Dr Call option obligation	CU1,000
Cr Gain	CU1,000

To record the decrease in the fair value of the option.

On the same day, Entity B exercises the call option and the contract is settled net in cash. Entity A has an obligation to deliver CU104,000 ($CU104 \times 1,000$) to Entity B in exchange for CU102,000 ($CU102 \times 1,000$) from Entity B, so Entity A pays a net amount of CU2,000.

Dr Call option obligation	CU2,000
Cr Cash	CU2,000

To record the settlement of the option contract.

(b) Shares for shares ('net share settlement')

IE19. Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. Entity A's journal entries are the same as those shown in (a), except for recording the settlement of the option contract, as follows:

December 31, 20X3

Entity B exercises the call option and the contract is settled net in shares. Entity A has an obligation to deliver CU104,000 ($CU104 \times 1,000$) worth of Entity A's shares to Entity B in exchange for CU102,000 ($CU102 \times 1,000$) worth of Entity A's shares.

Thus, Entity A delivers the net amount of CU2,000 worth of shares to Entity B, i.e. 19.2 shares (CU2,000/CU104).

Dr Call option obligation	CU2,000
Cr Net assets	CU2,000

To record the settlement of the option contract. The settlement is accounted for as a net assets transaction.

(c) Cash for shares ('gross physical settlement')

IE20. Assume the same facts as in (a) except that settlement will be made by delivering a fixed number of shares and receiving a fixed amount of cash, if Entity B exercises the option. Similarly to (a) and (b) above, the exercise price per share is fixed at CU102. Accordingly, Entity B has a right to receive 1,000 of Entity A's own outstanding shares in exchange for CU102,000 (CU102 × 1,000) in cash, if Entity B exercises its option. Entity A records the following journal entries.

February 1, 20X2

Dr Cash	CU5,000
Cr Net assets	CU5,000

To record the cash received in exchange for the obligation to deliver a fixed number of Entity A's own shares in one year for a fixed price. The premium received is recognized in net assets. Upon exercise, the call would result in the issue of a fixed number of shares in exchange for a fixed amount of cash.

December 31, 20X3

No entry is made on December 31, 20X3 because no cash is paid or received and a contract to deliver a fixed number of Entity A's own shares in exchange for a fixed amount of cash meets the definition of an equity instrument of the entity.

January 31, 20X4

Entity B exercises the call option and the contract is settled gross. Entity A has an obligation to deliver 1,000 shares in exchange for CU102,000 in cash.

Dr Cash	CU102,000
Cr Net assets	CU102,000

To record the settlement of the option contract.

(d) Settlement options

IE21. The existence of settlement options (such as net in cash, net in shares or by an exchange of cash and shares) has the result that the call option is a financial liability. It does not meet the definition of an equity instrument because it can be settled otherwise than by Entity A issuing a fixed number of its own shares in exchange for receiving a fixed amount of cash or another financial asset. Entity A recognizes a derivative liability, as illustrated in (a) and (b) above. The accounting entry to be made on settlement depends on how the contract is actually settled. Example 5: Purchased put option on shares

IE22. This example illustrates the journal entries for a purchased put option on the entity's own shares that will be settled (a) net in cash, (b) net in shares or (c) by delivering cash in exchange for shares. It also discusses the effect of settlement options (see (d) below).

Assumptions:

Contract date February 1, 20X2

Exercise date January 31, 20X4

(European terms, i.e. it can be exercised only at maturity)

Exercise right holder Reporting entity
(Entity A)

Market price per share on February 1, 20X2 CU100

Market price per share on December 31, 20X3 CU95

Market price per share on January 31, 20X4 CU95

Fixed exercise price to be paid on January 31, 20X4 CU98

Number of shares under option contract 1,000

Fair value of option on February 1, 20X2 CU5,000

Fair value of option on December 31, 20X3 CU4,000

Fair value of option on January 31, 20X4 CU3,000

(a) Cash for cash ('net cash settlement')

IE23. On February 1, 20X2, Entity A enters into a contract with Entity B that gives Entity A the right to sell, and Entity B the obligation to buy the fair value of 1,000 of Entity A's own outstanding ordinary shares as of January 31, 20X4 at a strike price of CU98,000 (i.e. CU98 per share) on January 31, 20X4, if Entity A exercises that right. The contract will be settled net in

cash. If Entity A does not exercise its right, no payment will be made. Entity A records the following journal entries.

February 1, 20X2

The price per share when the contract is agreed on February 1, 20X2 is CU100. The initial fair value of the option contract on February 1, 20X2 is CU5,000, which Entity A pays to Entity B in cash on that date. On that date, the option has no intrinsic value, only time value, because the exercise price of CU98 is less than the market price per share of CU100. Therefore it would not be economic for Entity A to exercise the option. In other words, the put option is out of the money.

Dr Put option asset	CU5,000
Cr Cash	CU5,000

To recognize the purchased put option.

December 31, 20X3

On December 31, 20X3 the market price per share has decreased to CU95. The fair value of the put option has decreased to CU4,000, of which CU3,000 is intrinsic value $(\text{CU}98 - \text{CU}95) \times 1,000$ and CU1,000 is the remaining time value.

Dr Loss	CU1,000
Cr Put option asset	CU1,000

To record the decrease in the fair value of the put option.

January 31, 20X4

On January 31, 20X4 the market price per share is still CU95. The fair value of the put option has decreased to CU3,000, which is all intrinsic value $(\text{CU}98 - \text{CU}95) \times 1,000$ because no time value remains.

Dr Loss	CU1,000
Cr Put option asset	CU1,000

To record the decrease in the fair value of the option.

On the same day, Entity A exercises the put option and the contract is settled net in cash. Entity B has an obligation to deliver CU98,000 to Entity A and Entity A has an obligation to deliver CU95,000 $(\text{CU}95 \times 1,000)$ to Entity B, so Entity B pays the net amount of CU3,000 to Entity A.

Dr Cash	CU3,000
Cr Put option asset	CU3,000

To record the settlement of the option contract.

(b) Shares for shares ('net share settlement')

IE24. Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. Entity A's journal entries are the same as shown in (a), except:

January 31., 20X4

Entity A exercises the put option and the contract is settled net in shares. In effect, Entity B has an obligation to deliver CU98,000 worth of Entity A's shares to Entity A, and Entity A has an obligation to deliver CU95,000 worth of Entity A's shares ($CU95 \times 1,000$) to Entity B, so Entity B delivers the net amount of CU3,000 worth of shares to Entity A, i.e. 31.6 shares ($CU3,000/CU95$).

<u>Dr Net assets</u>	<u>CU3,000</u>
<u>Cr Put option asset</u>	<u>CU3,000</u>

To record the settlement of the option contract.

(c) Cash for shares ('gross physical settlement')

IE25. Assume the same facts as in (a) except that settlement will be made by receiving a fixed amount of cash and delivering a fixed number of Entity A's shares, if Entity A exercises the option. Similarly to (a) and (b) above, the exercise price per share is fixed at CU98. Accordingly, Entity B has an obligation to pay CU98,000 in cash to Entity A ($CU98 \times 1,000$) in exchange for 1,000 of Entity A's outstanding shares, if Entity A exercises its option. Entity A records the following journal entries.

February 1, 20X2

<u>Dr Net assets</u>	<u>CU5,000</u>
<u>Cr Cash</u>	<u>CU5,000</u>

To record the cash received in exchange for the right to deliver Entity A's own shares in one year for a fixed price. The premium paid is recognized directly in net assets. Upon exercise, it results in the issue of a fixed number of shares in exchange for a fixed price.

December 31, 20X3

No entry is made on December 31, 20X3 because no cash is paid or received and a contract to deliver a fixed number of Entity A's own shares in exchange for a fixed amount of cash meets the definition of an equity instrument of Entity A.

January 31, 20X4

Entity A exercises the put option and the contract is settled gross. Entity B has an obligation to deliver CU98,000 in cash to Entity A in exchange for 1,000 shares.

<u>Dr Cash</u>	<u>CU98,000</u>
<u>Cr Net assets</u>	<u>CU98,000</u>

To record the settlement of the option contract.

(d) Settlement options

IE26. The existence of settlement options (such as net in cash, net in shares or by an exchange of cash and shares) has the result that the put option is a financial asset. It does not meet the definition of an equity instrument because it can be settled otherwise than by Entity A issuing a fixed number of its own shares in exchange for receiving a fixed amount of cash or another financial asset. Entity A recognizes a derivative asset, as illustrated in (a) and (b) above. The accounting entry to be made on settlement depends on how the contract is actually settled.

Example 6: Written put option on shares

IE27. This example illustrates the journal entries for a written put option on the entity's own shares that will be settled (a) net in cash, (b) net in shares or (c) by delivering cash in exchange for shares. It also discusses the effect of settlement options (see (d) below).

Assumptions:

Contract date February 1, 20X2

Exercise date January 31, 20X3

(European terms, i.e. it can be exercised only at maturity)

Exercise right holder Counterparty
(Entity B)

Market price per share on February 1, 20X2 CU100

<u>Market price per share on December 31, 20X3</u>	<u>CU95</u>
<u>Market price per share on January 31, 20X4</u>	<u>CU95</u>
<u>Fixed exercise price to be paid on January 31, 20X4</u>	<u>CU98</u>
<u>Present value of exercise price on February 1, 20X2</u>	<u>CU95</u>
<u>Number of shares under option contract</u>	<u>1,000</u>
<u>Fair value of option on February 1, 20X2</u>	<u>CU5,000</u>
<u>Fair value of option on December 31, 20X3</u>	<u>CU4,000</u>
<u>Fair value of option on January 31, 20X4</u>	<u>CU3,000</u>

(a) Cash for cash ('net cash settlement')

IE28. Assume the same facts as in Example 5(a) above, except that Entity A has written a put option on its own shares instead of having purchased a put option on its own shares. Accordingly, on February 1, 20X2, Entity A enters into a contract with Entity B that gives Entity B the right to receive and Entity A the obligation to pay the fair value of 1,000 of Entity A's outstanding ordinary shares as of January 31, 20X4 in exchange for CU98,000 in cash (i.e. CU98 per share) on January 31, 20X4, if Entity B exercises that right. The contract will be settled net in cash. If Entity B does not exercise its right, no payment will be made. Entity A records the following journal entries.

February 1, 20X2

<u>Dr Cash</u>	<u>CU5,000</u>
<u> Cr Put option liability</u>	<u>CU5,000</u>

To recognize the written put option.

December 31, 20X3

<u>Dr Put option liability</u>	<u>CU1,000</u>
<u> Cr Gain</u>	<u>CU1,000</u>

To record the decrease in the fair value of the put option.

January 31, 20X4

<u>Dr Put option liability</u>	<u>CU1,000</u>
<u> Cr Gain</u>	<u>CU1,000</u>

To record the decrease in the fair value of the put option.

On the same day, Entity B exercises the put option and the contract is settled net in cash. Entity A has an obligation to deliver CU98,000 to Entity B, and Entity B has an obligation to deliver CU95,000 ($\text{CU}95 \times 1,000$) to Entity A. Thus, Entity A pays the net amount of CU3,000 to Entity B.

Dr Put option liability	CU3,000
Cr Cash	CU3,000

To record the settlement of the option contract.

(b) Shares for shares ('net share settlement')

IE29. Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. Entity A's journal entries are the same as those in (a), except for the following:

January 31, 20X4

Entity B exercises the put option and the contract is settled net in shares. In effect, Entity A has an obligation to deliver CU98,000 worth of shares to Entity B, and Entity B has an obligation to deliver CU95,000 worth of Entity A's shares ($\text{CU}95 \times 1,000$) to Entity A. Thus, Entity A delivers the net amount of CU3,000 worth of Entity A's shares to Entity B, i.e. 31.6 shares ($3,000/95$).

Dr Put option liability	CU3,000
Cr Net assets	CU3,000

To record the settlement of the option contract. The issue of Entity A's own shares is accounted for as a net assets transaction.

(c) Cash for shares ('gross physical settlement')

IE30. Assume the same facts as in (a) except that settlement will be made by delivering a fixed amount of cash and receiving a fixed number of shares, if Entity B exercises the option. Similarly to (a) and (b) above, the exercise price per share is fixed at CU98. Accordingly, Entity A has an obligation to pay CU98,000 in cash to Entity B ($\text{CU}98 \times 1,000$) in exchange for 1,000 of Entity A's outstanding shares, if Entity B exercises its option. Entity A records the following journal entries.

February 1, 20X2

Dr Cash	CU5,000
---------	---------

Cr Net assets CU5,000

To recognize the option premium received of CU5,000 in net assets.

Dr Net assets CU95,000

Cr Liability CU95,000

To recognize the present value of the obligation to deliver CU98,000 in one year, i.e. CU95,000, as a liability.

December 31, 20X3

Dr Interest expense CU2,750

Cr Liability CU2,750

To accrue interest in accordance with the effective interest method on the liability for the share redemption amount.

January 31, 20X4

Dr Interest expense CU250

Cr Liability CU250

To accrue interest in accordance with the effective interest method on the liability for the share redemption amount.

On the same day, Entity B exercises the put option and the contract is settled gross. Entity A has an obligation to deliver CU98,000 in cash to Entity B in exchange for CU95,000 worth of shares ($CU95 \times 1,000$).

Dr Liability CU98,000

Cr Cash CU98,000

To record the settlement of the option contract.

(d) Settlement options

IE31. The existence of settlement options (such as net in cash, net in shares or by an exchange of cash and shares) has the result that the written put option is a financial liability. If one of the settlement alternatives is to exchange cash for shares ((c) above), Entity A recognizes a liability for the obligation to deliver cash, as illustrated in (c) above. Otherwise, Entity A accounts for the put option as a derivative liability.

Entities such as mutual funds and co-operatives whose share capital is not net assets/equity as defined in IPSAS 15

Example 7: Entities with no net assets

IE32. The following example illustrates a statement of financial performance and a statement of financial position format that may be used by entities such as mutual funds that do not have net assets as defined in IPSAS 15.

Statement of financial performance for the year ended December 31, 20X1

	<u>20X1</u>	<u>20X0</u>
	<u>CU</u>	<u>CU</u>
<u>Revenue</u>	<u>2,956</u>	<u>1,718</u>
<u>Expenses (classified by nature or function)</u>	<u>(644)</u>	<u>(614)</u>
<u>Surplus from operating activities</u>	<u>2,312</u>	<u>1,104</u>
<u>Finance costs</u>		
<u>– other finance costs</u>	<u>(47)</u>	<u>(47)</u>
<u>– distributions to unitholders</u>	<u>(50)</u>	<u>(50)</u>
<u>Change in net assets attributable to unitholders</u>	<u>2,215</u>	<u>1,007</u>

Statement of financial position at December 31., 20X1

	<u>CU</u>	<u>20X1</u> <u>CU</u>	<u>CU</u>	<u>20X0</u> <u>CU</u>
<u>ASSETS</u>				
<u>Non-current assets</u> <u>(classified in accordance with IPSAS 1)</u>	<u>91,374</u>		<u>78,484</u>	
<u>Total non-current assets</u>		<u>91,374</u>		<u>78,484</u>
<u>Current assets</u> <u>(classified in accordance with IPSAS 1)</u>	<u>1,422</u>		<u>1,769</u>	
<u>Total current assets</u>		<u>1,422</u>		<u>1,769</u>
<u>Total assets</u>		<u>92,796</u>		<u>80,253</u>
<u>LIABILITIES</u>				
<u>Current liabilities</u> <u>(classified in accordance With IPSAS 1)</u>	<u>647</u>		<u>66</u>	
<u>Total current liabilities</u>		<u>(647)</u>		<u>(66)</u>
<u>Non-current liabilities excluding net assets</u> <u>attributable to unitholders (classified in</u> <u>accordance with IPSAS 1)</u>	<u>280</u>		<u>136</u>	
		<u>(280)</u>		<u>(136)</u>
<u>Net assets attributable to unitholders</u>		<u>91,869</u>		<u>80,051</u>

Example 8: Entities with some net assets

IE33. The following example illustrates a statement of financial performance and a statement of financial position format that may be used by entities whose share capital is not net assets as defined in the IPSAS 15, “Financial Instruments: Presentation” because the entity has an obligation to repay the share capital on demand. Other formats are possible.

Statement of financial performance for the year ended December 31, 20X1

	<u>20X1</u>	<u>20X0</u>
	<u>CU</u>	<u>CU</u>
<u>Revenue</u>	<u>472</u>	<u>498</u>
<u>Expenses (classified by nature or function)</u>	<u>(367)</u>	<u>(396)</u>
<u>Surplus from operating activities</u>	<u>105</u>	<u>102</u>
<u>Finance costs</u>		
– other finance costs	(4)	(4)
– distributions to members	(50)	(50)
<u>Change in net assets attributable to members</u>	<u>51</u>	<u>48</u>

Statement of financial position at December 31, 20X1

	<u>20X1</u>		<u>20X0</u>	
	<u>CU</u>	<u>CU</u>	<u>CU</u>	<u>CU</u>
<u>ASSETS</u>				
<u>Non-current assets</u>				
(classified in accordance with IPSAS 1)	908		830	
<u>Total non-current assets</u>		908		830
<u>Current assets</u>				
(classified in accordance with IPSAS 1)	383		350	
<u>Total current assets</u>		383		350
<u>Total assets</u>		1,291		1,180
<u>LIABILITIES</u>				
<u>Current liabilities</u>				
(classified in accordance with IPSAS 1)	372		338	
<u>Share capital repayable on demand</u>	202		161	
<u>Total current liabilities</u>		(574)		(499)
<u>Total assets less current liabilities</u>		717		681
<u>Non-current liabilities</u>				
(classified in accordance with IPSAS 1)	187		196	
		(187)		(196)
<u>RESERVES(a)</u>				
<u>Reserves e.g. revaluation reserve, retained earnings etc</u>	530		485	
		530		485
		717		681
<u>MEMORANDUM NOTE – Total members' interests</u>				
<u>Share capital repayable on demand</u>		202		161
<u>Reserves</u>		530		485
		732		646

(a) In this example, the entity has no obligation to deliver a share of its reserves to its members.

Accounting for compound financial instruments

Example 9: Separation of a compound financial instrument on initial recognition

IE34. Paragraph 36 describes how the components of a compound financial instrument are separated by the entity on initial recognition. The following example illustrates how such a separation is made.

IE35. An entity issues 2,000 convertible bonds at the start of year 1. The bonds have a three-year term, and are issued at par with a face value of CU1,000 per bond, giving total proceeds of CU2,000,000. Interest is payable annually in arrears at a nominal annual interest rate of 6 per cent. Each bond is convertible at any time up to maturity into 250 ordinary shares. When the bonds are issued, the prevailing market interest rate for similar debt without conversion options is 9 per cent.

IE36. The liability component is measured first, and the difference between the proceeds of the bond issue and the fair value of the liability is assigned to the net assets component. The present value of the liability component is calculated using a discount rate of 9 per cent, the market interest rate for similar bonds having no conversion rights, as shown below.

	<u>CU</u>
<u>Present value of the principal – CU2,000,000 payable at the end of three years</u>	<u>1,544,367</u>
<u>Present value of the interest – CU120,000 payable annually in arrears for three years</u>	<u>303,755</u>
<u>Total liability component</u>	<u>1,848,122</u>
<u>Net assets component (by deduction)</u>	<u>151,878</u>
<u>Proceeds of the bond issue</u>	<u>2,000,000</u>

Example 10: Separation of a compound financial instrument with multiple embedded derivative features

IE37. The following example illustrates the application of paragraph 40 to the separation of the liability and net assets components of a compound financial instrument with multiple embedded derivative features.

IE38. Assume that the proceeds received on the issue of a callable convertible bond are CU60. The value of a similar bond without a call or net assets conversion option is CU57. Based on an option pricing model, it is determined that the value to the entity of the embedded call feature in a similar bond without a net assets conversion option is CU2. In this case, the value allocated to the liability component under paragraph 37 is CU55 (CU57 – CU2) and the value allocated to the net assets component is CU5 (CU60 – CU55).

Example 11: Repurchase of a convertible instrument

IE39. The following example illustrates how an entity accounts for a repurchase of a convertible instrument. For simplicity, at inception, the face amount of the instrument is assumed to be equal to the aggregate carrying amount of its liability and net assets components in the financial statements, i.e. no original issue premium or discount exists. Also, for simplicity, tax considerations have been omitted from the example.

IE40. On April 1, 19X9, Entity A issued a 10 per cent convertible debenture with a face value of CU1,000 maturing on December 31, 20X8. The debenture is convertible into ordinary shares of Entity A at a conversion price of CU25 per share. Interest is payable half-yearly in cash. At the date of issue, Entity A could have issued non-convertible debt with a ten-year term bearing a coupon interest rate of 11 per cent.

IE41. In the financial statements of Entity A the carrying amount of the debenture was allocated on issue as follows:

<u>Liability component</u>	<u>CU</u>
<u>Present value of 20 half-yearly interest payments of CU50, discounted at 11%</u>	<u>597</u>
<u>Present value of CU1,000 due in 10 years, discounted at 11%, compounded half-yearly</u>	<u>343</u>
	<u>940</u>
<u>Net assets/equity component</u>	
<u>(difference between CU1,000 total proceeds and CU940 allocated above)</u>	<u>60</u>
<u>Total proceeds</u>	<u>1,000</u>

IE42. On April 1, 2004, the convertible debenture has a fair value of CU1,700.

IE43. Entity A makes a tender offer to the holder of the debenture to repurchase the debenture for CU1,700, which the holder accepts. At the date of repurchase, Entity A could have issued non-convertible debt with a five-year term bearing a coupon interest rate of 8 per cent.

IE44. The repurchase price is allocated as follows:

	<u>Carrying value</u>	<u>Fair value</u>	<u>Difference</u>
	<u>CU</u>	<u>CU</u>	<u>CU</u>
<u>Liability component:</u>			
<u>Present value of 10 remaining half-yearly interest payments of CU50, discounted at 11% and 8%, respectively</u>	<u>377</u>	<u>405</u>	
<u>Present value of CU1,000 due in 5 years, discounted at 11% and 8%, compounded half-yearly, respectively</u>	<u>585</u>	<u>676</u>	
	<u>962</u>	<u>1,081</u>	<u>(119)</u>
<u>Net assets component</u>	<u>60</u>	<u>619 (a)</u>	<u>(559)</u>
<u>Total</u>	<u>1,022</u>	<u>1,700</u>	<u>(678)</u>

(a) This amount represents the difference between the fair value amount allocated to the liability component and the repurchase price of CU1,700.

IE45. Entity A recognizes the repurchase of the debenture as follows:

<u>Dr Liability component</u>	<u>CU962</u>	
<u>Dr Debt settlement expense (income statement)</u>	<u>CU119</u>	
<u> Cr Cash</u>		<u>CU1,081</u>

To recognize the repurchase of the liability component.

<u>Dr Net assets</u>	<u>CU619</u>	
<u> Cr Cash</u>		<u>CU619</u>

To recognize the cash paid for the net assets component.

IE46. The net assets component remains as net assets, but may be transferred from one line item within net assets to another.

Example 12: Amendment of the terms of a convertible instrument to induce early conversion

IE47. The following example illustrates how an entity accounts for the additional consideration paid when the terms of a convertible instrument are amended to induce early conversion.

IE48. On 1 April 1999, Entity A issued a 10 per cent convertible debenture with a face value of CU1,000 with the same terms as described in Example 11. On 1 April 20X0, to induce the holder to convert the convertible debenture promptly, Entity A reduces the conversion price to CU20 if the debenture is converted before 1 March 2000 (i.e. within 60 days).

IE49. Assume the market price of Entity A's ordinary shares on the date the terms are amended is CU40 per share. The fair value of the incremental consideration paid by Entity A is calculated as follows:

Number of ordinary shares to be issued to debenture holders under **amended** conversion terms:

<u>Face amount</u>	<u>CU1,000</u>	
<u>New conversion price</u>	<u>/CU20</u>	<u>per share</u>
<u>Number of ordinary shares to be issued on conversion</u>	<u>50</u>	<u>shares</u>

Number of ordinary shares to be issued to debenture holders under **original** conversion terms:

<u>Face amount</u>	<u>CU1,000</u>	
<u>Original conversion price</u>	<u>/CU25</u>	<u>per share</u>
<u>Number of ordinary shares to be issued on conversion</u>	<u>40</u>	<u>shares</u>

Number of incremental ordinary shares issued upon conversion 10 shares Value of **incremental** ordinary shares issued upon conversion

<u>CU40 per share x 10 incremental shares</u>	<u>CU400</u>
---	--------------

IE50. The incremental consideration of CU400 is recognized as a loss in surplus or deficit.

Examples of Disclosure Requirements

~~This appendix is illustrative only and does not form part of the standards. The purpose of the appendix is to illustrate the application of the standards and to assist in clarifying their meaning. The appendix illustrates an economic entity which includes a number of partly privatized GBEs that have issued convertible notes and preference shares.~~

The examples of disclosure requirements have been deleted as per the IASB's improvements project.

Note X1.—Summary of Accounting Policies (Extract)

Trade Receivables

~~Trade receivables are carried at original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts at the year end. Bad debts are written off when identified.~~

Investments

~~Interests in listed and unlisted securities, other than controlled entities and associates in the consolidated financial statements, are recognized at cost and dividend revenue is recognized in the statement of financial performance when receivable.~~

~~The principal amount of zero coupon bonds is calculated by discounting the cash flow associated with the ultimate redemption of the investment. The discount is amortized over the period to maturity. The discount rate is that implicit in the transaction.~~

Borrowings

~~Loans and debentures are carried at their principal amounts which represent the present value of future cash flows associated with servicing the debt. Interest is accrued over the period it becomes due and is recorded as part of other creditors.~~

~~On issue of convertible notes, the fair value of the liability component, being the obligation to make future payments of principal and interest to noteholders, is calculated using a market interest rate for an equivalent non-convertible note. The residual amount, representing the fair value of the conversion option, is included in equity as other equity securities with no recognition of any change in the value of the option in subsequent periods. The liability is included in borrowings and carried on an amortized cost basis with interest on the notes recognized as borrowing costs on an effective yield basis until the liability is extinguished on conversion or maturity of the notes.~~

~~Redeemable preference shares which provide for mandatory redemption or which are redeemable at the option of the holder are included in liabilities as they are, in substance, borrowings. Dividends payable on the shares are recognized in the statement of financial performance as interest and finance charges on an accruals basis.~~

~~*Derivative Financial Instruments*~~

~~The entity enters into forward foreign exchange contracts and interest rate swap agreements.~~

~~The net amount receivable or payable under interest rate swap agreements is progressively recognized over the period to settlement. The amount recognized is accounted for as an adjustment to interest and finance charges during the period and included in other debtors or other creditors at each reporting date.~~

~~**Note X2. Financial Risk Management**~~

~~*Financial Risk Factors*~~

~~The entity's activities expose it to a variety of financial risks, including the effects of: changes in debt and equity market prices, foreign currency exchange rates and interest rates. The entity's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the financial performance of the entity. The entity uses derivative financial instruments such as interest rate swaps and foreign exchange contracts to hedge certain exposures.~~

~~Risk management is carried out by a central treasury agency (Treasury Corporation) under policies approved by its Governing Board and consistent with the prudential guidelines set down by the Ministry for Finance. Treasury Corporation identifies, evaluates and hedges financial risks in close co-operation with the operating units. The Board provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and investing excess liquidity.~~

~~*Interest Rate Risk*~~

~~The entity's revenue and operating cash flows are substantially independent of changes in market interest rates. The entity has no significant interest-bearing assets. The entity's policy is to maintain approximately 80% of its borrowings in fixed rate instruments. At the year end 75% were at fixed rates. The entity sometimes borrows at variable rates and uses interest rate swaps as cash flow hedges of future interest payments, which have the economic effect of converting borrowings from floating rates to fixed rates. The interest rate swaps allow the entity to raise long-term borrowings at floating rates and swap them into fixed rates that are lower than those available if it borrowed at fixed rates directly. Under the interest rate swaps, the~~

entity agrees with other parties to exchange, at specified intervals (mainly quarterly), the difference between fixed contract rates and floating rate interest amounts calculated by reference to the agreed notional principal amounts.

Credit Risk

The entity has no significant concentrations of credit risk. Derivative counterparties and cash transactions are limited to high credit quality financial institutions. The entity has policies that limit the amount of credit exposure to any one financial institution.

Liquidity Risk

Prudent liquidity risk management includes maintaining sufficient cash and marketable securities, the availability of funding through an adequate amount of committed credit facilities and the ability to close out market positions. Treasury Corporation aims at maintaining flexibility in funding by keeping committed credit lines available.

Fair Value Estimation

The fair value of publicly traded derivatives and trading and available-for-sale securities is based on quoted market prices at the reporting date. The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows. The fair value of forward foreign exchange contracts is determined using forward exchange market rates at the reporting date.

In assessing the fair value of non-traded derivatives and other financial instruments, the entity uses a variety of methods and makes assumptions that are based on market conditions existing at each reporting date. Quoted market prices or dealer quotes for the specific or similar instruments are used for long-term debt. Other techniques, such as option pricing models and estimated discounted value of future cash flows, are used to determine fair value for the remaining financial instruments.

The face values less any estimated credit adjustments for financial assets and liabilities with a maturity of less than one year are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate available to the entity for similar financial instruments.

Note X3. — Financial Instruments

(i) — Off-balance-sheet Derivative Instruments

The entity is party to derivative financial instruments in the normal course of its operations in order to hedge exposure to fluctuations in interest and foreign exchange rates.

Interest Rate Swap Contracts

Loans of the entity currently bear an average variable interest rate of 8.5%. It is policy to protect part of the loans from exposure to increasing interest rates. Accordingly, the entity has entered into interest rate swap contracts under which it is obliged to receive interest at variable rates and to pay interest at fixed rates. The contracts are settled on a net basis and the net amount receivable or payable at the reporting date is included in other debtors or other creditors.

The contracts require settlement of net interest receivable or payable each 90 days. The settlement dates coincide with the dates on which interest is payable on the underlying debt.

Swaps currently in place cover approximately 60% (20X1 40%) of the loan principal outstanding and are timed to expire as each loan repayment falls due. The fixed interest rates range between 7.8% and 8.3% (20X1 9.0% and 9.6%) and the variable rates are between 0.5% and 1.0% above the 90 day bank bill rate which at the reporting date was 8.2% (20X1 9.4%).

At 30 June 20X2, the notional principal amounts and periods of expiry of the interest rate swap contracts are as follows:

	20X2	20X1
	\$'000	\$'000
Less than 1 year	30	20
1–2 years	250	170
2–3 years	250	170
3–4 years	300	80
4–5 years	180	–
	1,010	440

Forward Exchange Contracts

The passenger rail system is being substantially upgraded. New rolling stock is being purchased from Country A and Country B. In order to protect against exchange rate movements, the entity has entered into forward exchange contracts to purchase Foreign Currency A (FCA) and Foreign Currency B (FCB).

The contracts are timed to mature when major shipments of rolling stock are scheduled to arrive and cover anticipated purchases for the ensuing financial year.

At the reporting date, the details of outstanding contracts are:

Buy FCA	Sell Domestic Currency		Average exchange rate	
	20X2	20X1	20X2	20X1
	\$'000	\$'000		

Maturity

0–6 months	2,840	3,566	0.7042	0.7010
6–12 months	4,152	1,466	0.7225	0.6820

Buy FCB	Sell Domestic Currency		Average exchange rate	
	20X2	20X1	20X2	20X1
	\$'000	\$'000		

Maturity

0–6 months	4,527	2,319	0.6627	0.6467
6–12 months	–	1,262	–	0.6337

As these contracts are hedging anticipated future purchases, any unrealized gains and losses on the contracts, together with the cost of the contracts, are deferred and will be recognized in the measurement of the underlying transaction. Included in the amounts deferred are any gains and losses on hedging contracts terminated prior to maturity where the related hedged transaction is still expected to occur.

(ii) Credit Risk Exposures

The credit risk on financial assets of the entity which have been recognized on the statement of financial position, other than investments in shares, is generally the carrying amount, net of any provisions for doubtful debts.

~~Bills of exchange and zero coupon bonds which have been purchased at a discount to face value, are carried on the statement of financial position at an amount less than the amount realizable at maturity. The total credit risk exposure of the entity could also be considered to include the difference between the carrying amount and the realizable amount.~~

~~The recognized financial assets of the consolidated entity include amounts receivable arising from unrealized gains on derivative financial instruments. For off balance-sheet financial instruments, including derivatives, which are deliverable, credit risk also arises from the potential failure of counterparties to meet their obligations under the respective contracts at maturity. A material exposure arises from forward exchange contracts and the consolidated entity is exposed to loss in the event that counterparties fail to deliver the contracted amount. At the reporting date the following amounts are receivable (domestic currency equivalents):~~

	20X2	20X1
	-\$'000	-\$'000
Domestic Currency	2,073	1,422
Foreign Currency	11,599	8,613

(iii) Interest Rate Risk Exposures

~~The entity's exposure to interest rate risk and the effective weighted average interest rate by maturity periods is set out in the following table. For interest rates applicable to each class of asset or liability refer to individual notes to the financial statements [not shown here].~~

~~Exposures arise predominantly from assets and liabilities bearing variable interest rates as the entity intends to hold fixed rate assets and liabilities to maturity.~~

(iv) Net Fair Value of Financial Assets and Liabilities

On-balance sheet

~~The net fair value of cash and cash equivalents and non-interest bearing monetary financial assets and financial liabilities of the entity approximates their carrying amounts.~~

~~The net fair value of other monetary financial assets and financial liabilities is based upon market prices where a market exists or by discounting the expected future cash flows by the current interest rates for assets and liabilities with similar risk profiles.~~

~~Equity investments traded on organized markets have been valued by reference to market prices prevailing at the reporting date. For non-traded equity investments, the net fair value is an assessment by the Treasury Corporation based on the underlying net assets, future maintainable earnings and any special circumstances pertaining to a particular investment.~~

Off-balance sheet

~~The entity has been indemnified against any losses which might be incurred in relation to shares in certain non-government corporations. The net fair value of the indemnity has been taken to be the difference between the carrying amount and the net fair value of the shares.~~

~~The call option granting an unrelated party an option to acquire the entity's interest Inter Provincial Airlines is out of the money and the net fair value is immaterial.~~

~~Debentures which were the subject of an in-substance defeasance and for which the entity has guaranteed repayment have a net fair value equal to their face value.~~

~~The net fair value of financial assets or financial liabilities arising from interest rate swap agreements has been determined as the carrying amount, which represents the amount currently receivable or payable at the reporting date, and the present value of the estimated future cash flows which have not been recognized as an asset or liability.~~

~~For forward exchange contracts, the net fair value is taken to be the unrealized gain or loss at the reporting date calculated by reference to the current forward rates for contracts with similar maturity profiles.~~

~~The entity has potential financial liabilities which may arise from certain contingencies. No material losses are anticipated in respect of any of those contingencies and the net fair value disclosed below is the Ministry for Finance's estimate of amounts which would be payable by the entity as consideration for the assumption of those contingencies by another party.~~

The carrying amount and net fair values of financial assets and financial liabilities at the reporting date are:

	20X2		20X1	
	Carrying amount \$'000	Net fair value \$'000	Carrying amount \$'000	Net fair value \$'000
On-balance-sheet financial instruments				
Financial assets				
Cash	250	250	200	200
Deposits	3,952	3,952	2,881	2,881
Trade debtors	5,374	5,374	3,935	3,935
Bills of exchange	440	437	140	140
Loans to directors	147	121	136	107
Other debtors	424	425	124	124
Loans to related parties	800	800	200	200
Shares in other related parties	200	227	200	227
Shares in other corporations	100	100	200	190
Zero coupon bonds	60	58	–	–
Non-traded financial assets	11,747	11,744	8,016	8,004
Traded investments				
Shares in non-government corporations	1,100	900	100	60
Debentures	200	215	–	–
	13,047	12,859	8,116	8,064
Financial liabilities				
Trade creditors	2,405	2,405	1,762	1,762
Other creditors	740	740	650	650
Bank overdraft	2,350	2,350	2,250	2,250
Bank loans	530	537	900	898
Bills payable	250	241	130	130
Convertible notes	1,800	1,760	–	–
Redeemable preference shares	1,000	875	1,000	860
Other loans	430	433	150	150
Lease liabilities	575	570	650	643
Non-traded financial liabilities	10,080	9,911	7,492	7,343
Off-balance-sheet financial instruments	2,000	2,072	3,000	3,018
Financial assets	12,080	11,983	10,492	10,361

Indemnity received	— ⁽ⁱ⁾	200	— ⁽ⁱⁱ⁾	40
Forward exchange contracts	61 ⁽ⁱⁱⁱ⁾	61	26	26
Interest rate swaps	2 ⁽ⁱⁱⁱ⁾	13	1	2
	63—	274	27	68

Financial liabilities

Call options	—	—	—	—
Debentures defeased	—	1,000	—	—
Forward exchange contracts	607 ⁽ⁱⁱⁱ⁾	402	304	231
Contingencies	—	25	—	30
	607—	1,427	304	261

(i) Included in the carrying amount of traded investments above.

(ii) The carrying amounts are unrealized gains or losses which have been included in the on balance-sheet financial assets and liabilities disclosed above.

Other than those classes of assets and liabilities denoted as “traded,” none of the classes of financial assets and liabilities are readily traded on organized markets in standardized form.

Although certain financial assets are carried at an amount above net fair value, the Governing Board has not caused those assets to be written down as it is intended to retain those assets to maturity.

Net fair value is exclusive of costs which would be incurred on realization of an asset, and inclusive of costs which would be incurred on settlement of a liability.

The Basis for Conclusions has been adapted from the Basis for Conclusions used for the improved IPSASs, and provides reasons for variations from IAS 32.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of IPSAS 15, “Financial Instruments: Presentation.” This Basis for Conclusions only notes the IPSASB’s reasons for departing from the provisions of the related International Financial Reporting Standard.

Background

- BC1. The IPSASB’s policy is to converge the accrual basis International Public Sector Accounting Standards (IPSASs) with IFRSs issued by the International Accounting Standards Board where convergence is appropriate for public sector entities.
- BC2. Accrual Basis IPSASs that are converged with IFRSs maintain the requirements, structure and text of the IFRSs, unless there is a public sector specific reason for a departure. Departure from the equivalent IFRS occurs when requirements or terminology in the IFRS are not appropriate for the public sector, or when inclusion of additional commentary or examples is necessary to illustrate certain requirements in the public sector context. Differences between IPSASs and their equivalent IFRSs are identified in the “comparison with IFRS” included in each IPSAS.
- BC3. IPSAS 15, “Financial Instruments: Disclosure and Presentation” issued in December 2001 was based on IAS 32 (revised 1998), “Financial Instruments: Disclosure and Presentation.” IAS 32 was reissued in 2003 and subsequently amended by the issuance of IFRS 2, “Share-based Payment” (issued February 2004); IFRS 3, “Business Combinations” (issued March 2004); IFRS 4, “Insurance Contracts” (issued March 2004); and IFRS 7, “Financial Instruments: Disclosure”. IAS 32 has also been amended by amendments to IAS 39, “Financial Instruments: Recognition and Measurement” in June and August 2005, and by an amendment to IFRS 4 issued August 2005.
- BC4. A major consequence of the amendments to IAS 32 is that the disclosure requirements previously contained in that Standard have been removed, and new disclosure requirements established in IFRS 7. This means that IPSAS 15 is no longer consistent with IAS 32 and, therefore, under the IPSASB’s policy to converge where appropriate, IPSAS 15 needs to be updated to reflect the revised IAS 32. In revising the IPSAS the IPSASB has retained public sector differences that were included in the superseded IPSAS 15.

BC5. The IPSASB reviewed the revised IAS 32 and generally concurred with the IASB's reasons for revising the IAS and with the amendments made. (The IASB's Basis for Conclusions are not reproduced here. Subscribers to the IASB's *Comprehensive Subscription Service* can view the Basis for Conclusions on the IASB's website at www.iasb.org). The scope of IPSAS 15 is slightly different to that of IAS 32, to account for several public sector specific financial instruments that the IASB has not considered. This Basis for Conclusions explains the public sector specific reasons for departure.

Monetary gold

BC6. Monetary gold is gold of at least 995/1000 purity, that is classified as forming part of a country's "reserve assets", that is, assets that are held to meet a possible foreign exchange crisis. International agreements govern the circumstances in which gold is monetized or demonetized. These agreements classify monetary gold as a financial asset of a country's central bank, however, this financial asset does not have a counterparty. IAS 32 does not address monetary gold. Developing specific requirements for the presentation of monetary gold is beyond the limited scope of this project, and the IPSASB has deferred consideration of the issue.

Paragraphs BC6
– BC9 explain
the major
differences
between IPSAS
15 and IAS 32.

Special Drawing Rights in the International Monetary Fund

BC7. Special Drawing Rights (SDRs) in the International Monetary Fund (IMF) are rights allocated to the monetary authorities of IMF member countries. SDRs represent the right to receive foreign exchange from other members of the IMF in the event of a foreign exchange crisis. SDRs are traded between members of the IMF and a limited number of international institutions that are authorized by the IMF to hold SDRs. As currently defined in the statistical bases of reporting, SDRs are a financial asset without a corresponding financial liability.¹ IAS 32 does not address SDRs. Developing specific requirements for the presentation of SDRs is beyond the limited scope of this project, and the IPSASB has deferred consideration of the issue.

Currency issued by the entity

BC8. Currency (bank notes and coins) is generally issued by the monetary authority (or central bank) of a national government, however, in some jurisdictions private sector banks are authorized to issue bank notes on behalf of the monetary authority. In some jurisdictions, the central bank does not issue currency, but adopts the currency of another country. Some

¹ See for example, *Government Finance Statistics Manual 2001*, IMF, Washington DC, paragraph 7.95.

countries also join together in monetary unions to issue one currency for the several countries.

—BC9. IAS 32 does not address the presentation of currency issued by the entity. Developing specific requirements for the presentation of currency issued by the entity is beyond the limited scope of this project, and the IPSASB has deferred consideration of the issue.

Comparison with IAS 32

International Public Sector Accounting Standard (IPSAS) 15, “Financial Instruments: Disclosure and Presentation” is drawn primarily from International Accounting Standard (IAS) 32 (revised ~~1998~~2005), “Financial Instruments: ~~Disclosure and~~ Presentation.” The main differences between IPSAS 15 and IAS 32 are as follows:

- ~~• IAS 32 was amended in October 2000 to eliminate disclosure requirements that became redundant as a result of Internal Accounting Standard (IAS) 39, “Financial Instruments: Recognition and Measurement.” As yet, there is no IPSAS addressing the issue of the recognition and measurement of financial instruments. Consequently, the sections on Hedges of Anticipated Future Transactions and Other Disclosures have been retained in IPSAS 15.~~
- Commentary additional to that in IAS 32 has been included in IPSAS 15 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 15 uses different terminology, in certain instances, from IAS 32. The most significant examples are the use of the terms ~~“entity,”~~ “revenue,” “statement of financial performance,” “statement of financial position” (except for references to “on- and off-balance-sheet”) and “net assets/equity” (except for references to “equity instruments”) in IPSAS 15. The equivalent terms in IAS 32 are ~~“enterprise,”~~ “income,” “income statement,” “balance sheet” and “equity.”
- IPSAS 15 includes a definition of an insurance ~~contract~~contract; IAS 32 does not include this definition because it is defined in IFRS 4, “Insurance Contracts”. ~~Insurance contracts are only explained in commentary in IAS 32.~~
- IPSAS 15 includes definitions of special drawing rights in the International Monetary Fund” and monetary gold. IAS 32 does not include these definitions because these items cannot be held by non-public sector entities.
- IPSAS 15 includes an implementation guide to assist preparers of financial statements (Appendix 1). IAS 32 does not include such a guide.
- ~~• IPSAS 15 includes an illustration of the disclosures required under the Standard (Appendix 3). No example of disclosure requirements is included in IAS 32.~~

Given the rationale for initiating this project, it is no longer appropriate to include provisions relating to hedges.

Financial Instruments – Issues Paper

Introduction

Governments, particularly national governments, play an important role in the financial markets as regulator, issuer of risk free debt securities, and often as the monopoly operator of financial and or commodity markets. These roles enable the government to be not only the market regulator or operator, but to be a market participant as well.

Financial instruments are used extensively in the public sector for many of the same reasons, and in many of the same ways, that they are used in the private sector. Financial assets are used in the public sector:

- As official reserve assets;
- As operational tools, including accounts receivable;
- As investments, including those used to offset unfunded pension fund liabilities; and
- To manage the operational risks a public sector entity faces, such as the price of a commodity, interest rate variations, cash flows or foreign exchange rates.

Financial liabilities in the public sector are used to:

- Finance government activities; and
- Manage operational risks.

Equities are issued by public sector entities in limited circumstances. Equities are issued by a government or other public sector entity when a government business enterprise is partially privatized, or when a public sector entity is owned by two or more public sector entities and is established as a company with share capital.

Financial instruments are complex in nature, and analysis is needed to determine whether the item should be recognized, and, if so, whether an instrument should be classified as an asset, a liability or net assets/equity. Financial instruments are evolving, with new instruments continually being developed, and modifications being made to existing instrument types. These instruments are developed for a variety of reasons, including providing more innovative methods of managing the risks inherent in the modern economic environment. These instruments may also be developed with a view to assisting both private and public sector entities achieve desired financial reporting or taxation outcomes.

Derivative financial instruments, the value of which is dependant upon the value of another phenomenon, such as interest rates, exchange rates or commodity prices, are likely the most complex class of financial instrument. New derivative financial instruments are being developed continually, and each new instrument has different terms and conditions, adding layers of complexity. Classification of these instruments can be difficult, and valuation of instruments that are not traded on an active market is also difficult.

Current Pronouncements on Financial Instruments

IPSAS 15, “Financial Instruments: Disclosure and Presentation”

Currently there is an IPSAS that addresses the disclosure and presentation of information about financial instruments: IPSAS 15, “Financial Instruments: Disclosure and Presentation”. IPSAS 15 was developed from the 1998 revision of IAS 32. However, the provisions of IAS 32 have been further developed, and the disclosure requirements of IPSAS 15 are no longer harmonized with those of IFRS 7, “Financial Instruments: Disclosures.” The presentation requirements of IPSAS 15 are largely in harmony with those in IAS 32, “Financial Instruments: Presentation”. There is no IPSAS that specifically addresses the recognition and measurement of financial instruments. So IPSAS 15 is deficient in a number of respects: its disclosure requirements do not converge with IFRS 7, it does not address the recognition and measurement of financial instruments, and, most importantly, it does not address the financial reporting of public sector specific financial instruments.

Current Position of the IASB

The International Accounting Standards Board has issued three Standards specifically addressing financial instruments:

- IFRS 7, “Financial Instruments: Disclosures” (Issued August 2005)
- IAS 32, “Financial Instruments: Presentation” (Amended August 2005)
- IAS 39, “Financial Instruments: Recognition and Measurement” (Amended August 2005)

IAS 32 was initially approved in 1995 as “Financial Instruments: Disclosure and Presentation” and has been revised periodically ever since, most recently in 2005 when the disclosure requirements were removed and new disclosures established by IFRS 7. IAS 39 was initially approved in 1998 and has also been revised periodically.

The IASB, as part of the IASB-FASB convergence project, has ongoing long-term project addressing financial reporting requirements for financial instruments. The IASB states its long term objectives in a document published on its website. Its long term objectives are:

1. To require that all financial instruments be measured at fair value with realized and unrealized gains and losses recognized in the period in which they occur.
2. To simplify or eliminate the need for special hedge accounting requirements.
3. To develop a new standard for the derecognition of financial instruments.

The IASB’s financial instruments project is anticipated to take a number of years to complete, although parts of the project will be completed sooner. IAS 32, for example, will be amended within two years to address “puttable instruments.”

The IASB has publicly stated its reservations about its current approach to developing IFRSs for financial instruments. The IASB is of the view that providing additional requirements and guidance to satisfy particular users’ adds complexity to the standards.

The IASB's long term goals reflect its disquiet with the current approach -it believes that the long term goals will simplify the financial reporting of financial instruments, if they can be implemented.

Government Finance Statistics Manual 2001

The Government Finance Statistics Manual 2001 (GFSM 2001) requires institutional units to recognize financial assets and liabilities at their market value, with changes in market value recognized in the statement of other economic flows. Financial assets and liabilities are presented in the Balance Sheet of the institutional unit that controls the asset or liability.

Current practice

Developing financial reporting requirements addressing financial instruments has proved to be controversial for the International Accounting Standards Board. In particular, the 2003 edition of IAS 39, "Financial Instruments: Recognition and Measurement" has been accepted by the European Union only after modifications had been made to fair value measurement, and the EU continues to adopt a more liberal approach to hedge accounting than is permitted by IAS 39. In particular the EU does not agree with using fair value to measure an entity's own liabilities. The EU also does not agree with restricting hedge accounting to cash flow hedging, fair value hedging and hedging of a net investment in a foreign operation. The EU is of the view that the provisions of IAS 39 would not allow European banks to undertake a portfolio hedge of their core deposits. Consequently, the EU "carved out" the fair value and hedge accounting provisions of IAS 39.

In terms of the public sector, IPSASB constituents, including the OECD, EC and UN have reported that in the absence of an IPSAS addressing the recognition and measurement of financial instruments, entities are applying IAS 39 when preparing their financial statements. This may be satisfactory in the short to medium term, however, as IAS 32 and IFRS 7 diverge from IPSAS 15, problems are likely to arise for public sector reporting entities.

Issues addressed in Exposure Draft

Monetary Gold

Monetary gold is defined in the statistical bases of financial reporting as "Gold coins, ingots and bars with a purity of at least 995/1000 that are (1) owned by units that undertake monetary authority functions and (2) are a component of the nation's official reserve assets." Non-monetary gold is gold that is not monetary gold and is classified as a commodity and recognized under IPSAS 12, "Inventories". Certain items made of gold may be classified as plant or equipment and recognized under the provisions of IPSAS 17, "Property, Plant and Equipment", for example, a collection of gold coins controlled by a museum may be recognized as plant.

Monetary gold is an asset that is unique to the public sector, and is only held by the monetary authority of a national government. Monetary gold is classified in the statistical bases of financial reporting as a financial asset for which there is no corresponding

liability of a counterpart. In the statistical bases of financial reporting it is valued at the current price established in organized markets or in bilateral arrangements between monetary authorities.¹

Gold is monetized when it is acquired and classified as such. Gold is demonetized when it is reclassified as a commodity. In practice, few countries have monetized gold in recent decades, as most countries use other financial assets to build up their official reserve assets. Consequently, monetary gold is often recognized at a value that does not reflect the value of gold in the commodities market. For example, the United States Federal Reserve currently measures monetary gold at USD42.2222 per troy ounce whereas the commodity price on June 1, 2007 was USD671.50 per troy ounce. Monetary authorities in some countries periodically reclassify monetary gold as a commodity and sell it in the commodities market.

Neither the IFRSs nor the IPSASs currently address the recognition, measurement, disclosure or presentation of monetary gold. The limited scope of the IPSAS 15 convergence project means that the financial reporting of monetary gold will not be addressed at this time, however, the IPSASB may consider a project on this issue in the future.

Bank Notes and Coins on Issue

Monetary authorities of national governments issue bank notes and coins on a regular basis. There are also private sector banks in some countries that issue bank notes, however these banks are normally required to deposit an amount with the monetary authority equal to the amount of their notes on issue. The IASB has not considered the financial reporting treatment of issuing bank notes.

In the statistical bases of financial reporting currency is treated as a liability of the unit that issued the currency. When new currency is put into circulation, a transaction is recorded that increases the issuer's liability for currency. Usually the counterpart to the increase in liabilities is an increase in the issuer's financial assets, most likely deposits.

Neither the IFRSs nor the IPSASs currently address the issuing of currency. The limited scope of the IPSAS 15 convergence project means that the issuing of currency will not be addressed at this time, however, the IPSASB may consider a project on this issue in the future.

Special Drawing Rights

Special Drawing Rights (SDRs) are international reserve assets created by the International Monetary Fund (IMF) and allocated to its members to supplement existing reserve assets. SDRs are held only by the monetary authorities of IMF member countries and a limited number of authorized international financial institutions. An SDR is a financial asset for which there is no corresponding liability, and the IMF members to whom they have been allocated do not have an unconditional liability to repay their SDR allocations. An SDR represents an unconditional right to obtain foreign exchange or other

¹ IMF, *Government Finance Statistics Manual 2001*, Washington, USA, paragraph 7.93.

reserve assets from other IMF members. They can be sold, loaned or used to settle financial obligations. The value of the SDR is determined by the IMF as a weighted average of selected major currencies. Both the currencies and the weights are revised from time to time.¹

The IASB has not considered the financial reporting treatment of SDRs because these financial assets are not held by private sector companies. The IPSASB has not previously considered the financial reporting of SDRs, because it addressed financial instruments in the context of converging with IFRSs. The limited scope of the IPSAS 15 convergence project means that the financial reporting of SDRs will not be addressed at this time, however, the IPSASB may consider a project on this issue in the future.

Revising IPSAS 15

At its March 2007 meeting, the IPSASB considered whether to initiate a comprehensive project to develop a suite of IPSASs addressing the recognition, measurement, disclosure and presentation of financial instruments including revising IPSAS 15. The IPSASB concluded that, due to the rapidly evolving nature of the IASB's standards on financial instruments, and the lack of international consensus on the appropriate financial reporting of financial instruments, it would be prudent to delay a comprehensive project at this time. The IPSASB did decide, however, that it was important to revise IPSAS 15 to converge with IAS 32, so that entities reporting in accordance with IPSASs would not be faced with potentially conflicting requirements, if they adopt accounting policies for the recognition and measurement of financial instruments that are consistent with IAS 39.

In reaching this decision the IPSASB noted that:

- IPSAS 15 is no longer harmonized with IAS 32 and IFRS 7. If constituents are to be directed to the hierarchy, IPSAS 15 must be withdrawn, or amended to remove the disclosure requirements, and adjust the presentation requirements to ensure they are fully harmonized with IAS 32.
- The IPSASB was reluctant to withdraw IPSAS 15 when its presentation requirements are largely consistent with those in IAS 32. Withdrawing an IPSAS, may be perceived negatively in the financial reporting community, and could discourage some entities from adopting IPSASs.

¹ IMF, *Government Finance Statistics Manual 2001*, Washington, USA, paragraphs 7.95 – 7.96.