



**INTERNATIONAL FEDERATION
OF ACCOUNTANTS**

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**Agenda Item
2A**

DATE: January 27, 2009
MEMO TO: Members, Technical Advisors and Observers of the IPSASB
FROM: Jeanine Poggiolini (SAASB), John Stanford and Matthew Bohun-Aponte
SUBJECT: ED 37: Financial Instruments: Presentation

OBJECTIVE OF THIS SESSION

The objective of this session is to approve ED 37, “Financial Instruments: Presentation.”

ACTION REQUIRED

Members, Technical Advisors and Observers are asked to:

- **Consider** the revised versions of Exposure Draft (ED) 37, “Financial Instruments: Presentation”;
- **Consider** the issues raised in this memorandum and **confirm** the Staff action or **provide** alternative directions;
- **Highlight** further issues that are not considered in this memorandum and **provide** directions; and
- **Approve** ED 37, “Financial Instruments: Presentation.”

AGENDA MATERIAL

- 2A.1 Cut and Paste of responses to December 5th circulation of material
- 2A.2 Draft ED 37, “Financial Instruments: Presentation.” (Marked-up to show changes from the version circulated on December 5th)
- 2A.3 Draft ED 37, “Financial Instruments: Presentation.” (Marked-up to show all changes from December 31st 2009 versions of IAS 32, “Financial Instruments: Presentation” and IFRIC 2, “Members’ Shares in Co-operative Entities and Similar Instruments”)

BACKGROUND

At the Zurich Meeting in October 2008 Staff was directed to develop EDs based on IAS 32, “Financial Instruments: Presentation”, IAS 39, “Financial Instruments: Recognition and Measurement” and IFRS 7, “Financial Instruments: Disclosure.” The EDs based on IAS 32 and IAS 39 were to contain minimal changes from IAS 32 and IAS 39, predominantly to align the text with the terminology and references in other IPSASs. The term “connectivity” was used at Zurich to describe this process.

A preliminary version of ED 37, “Financial Statements: Presentation”, a mark-up of IAS 32, was prepared by Jeanine Poggiolini of the South African Accounting Standards

Board. This version of ED 37 was circulated on the intranet to Members, Technical Advisers and Observers on December 5th. A memorandum was also circulated asking for views and directions on issues identified by Staff. As at January 26th, 7 responses had been received. These responses are shown at Agenda Item 2A1. Copies of original responses are available from staff on request. Any further responses received by Staff will be tabled at the Paris meeting.

BASIS FOR DEVELOPMENT OF ED 37

ED 37 reflects all amendments either made or proposed by the IASB to IAS 32 and IFRIC 2, as at December 31st, 2008. ED 37 does, however, exclude the notion of comprehensive income and other changes made to IAS 1, “Presentation of Financial Statements” in the 2007 version and subsequently, as the IPSASB has not yet considered these amendments in the context of IPSAS 1, “Presentation of Financial Statements.”

The IASB’s proposed Annual Improvements published in August 2008 did not affect IAS 32 or IFRIC 2. The IASB’s amendments relating to investments in debt instruments and embedded derivatives published in December 2008 also did not affect IAS 32.

IFRIC 11, “IFRS 2- Group and Treasury Share Transactions” was not included in ED 37 as the Interpretation provides guidance on share-based payment transactions, which are not likely to exist in the public sector.

PRESENTATION OF AGENDA MATERIAL ON ED 37

Two versions of ED 37 have been included in the agenda material for the Paris meeting. Item 2A2 marks-up the changes made to the version of ED 37 circulated for comment in December. Item 2A3 is a mark-up, which shows changes from the texts of IAS 32, “Financial Instruments: Presentation” and IFRIC 2, “Members’ Interests in Co-operative Entities and Similar Instruments” as at December 31st 2008. This mark-up of IAS 32 and IFRIC 2 is presented as follows:

- Additions to IAS 32 are underlined and deletions are struck through;
- The text, as well as the Application Guidance, is cross-referenced to the corresponding paragraph in IAS 32, which is shown in the right hand margin. Any changes made to the paragraph are also highlighted in the right hand margin; and
- IFRIC 2, “Members’ Shares in Co-operative Entities and Similar Instruments” has been included as Appendix B. IFRIC 2 is not incorporated in IAS 32. In order to indicate the changes made to the text of the Interpretation, only changes to the text of Interpretation have been marked-up.

Sequential paragraph numbers in IAS 32 have not been struck through. As indicated above, there are references to the original paragraph numbers in IAS 32 in the right hand margin of Agenda Items 2A2 and 2A3.

SPECIFIC MATTERS FOR COMMENT AND CROSS-REFERENCES TO ED 38 & ED 39

No Specific Matters for Comment have been included. Decisions on whether, and, if so, what Specific Matters for Comment are necessary are contingent on decisions to be made at Paris. Cross-references to ED 38, “Financial Instruments: Recognition and Measurement” and ED 39, “Financial Instruments: Disclosures” need to be amended once the text and Application Guidance of those EDs is finalized.

ISSUES FOR CONSIDERATION BY THE IPSASB

The issues highlighted in this memorandum arise from changes proposed to the text of IAS 32 that have either been identified by Staff or Members during the development of ED 37 and the out-of-session consultation in December 2008 and January 2009.

Key Area 1: Scope

1.1 Insurance Contracts

Summary of IAS 32 requirements

IAS 32 excludes insurance contracts, as defined in IFRS 4, “Insurance Contracts”, from its scope. Elements of certain insurance contracts are, however, included in the scope of IAS 32, for example, embedded derivatives included in insurance contracts and insurance contracts that contain discretionary participation features. Financial guarantee contracts are treated as financial instruments unless an entity elects to apply IFRS 4, “Insurance Contracts” to such contracts, provided the entity has previously asserted that it regards financial guarantee contracts to be insurance contracts.

Insurance contracts are defined in IFRS 4 as: “A contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

Summary of IPSAS 15 (2001) requirements

IPSAS 15, “Financial Instruments: Disclosure and Presentation” excludes obligations arising from insurance contracts from its scope. Paragraph 6 of IPSAS 15 describes the substance of insurance contracts in the public sector. Paragraph 6 states: “...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.”

Paragraph 6 also states that “the provisions of this Standard apply when a financial instrument takes the form of an insurance contract but typically 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 are encouraged to apply IPSAS 15 to obligations arising from insurance contracts.

Proposed Approach in ED 37

ED 37 proposes the following approach for insurance contracts:

- (a) Insurance contracts are scoped out of ED 37, except for:
 - (i) Financial guarantee contracts;
 - (ii) Embedded derivatives included in insurance contracts that are accounted for using ED 38;
 - (iii) Insurance contracts that contain a discretionary participation feature. In such cases an entity applies paragraphs 1-12 and 40-62 of ED 37. The classification of these instruments into liabilities and equity is outside the scope of ED 37.
 - (iv) Financial instruments that are insurance contracts that involve the transfer of financial risks. Entities may apply the requirements of ED 37 to such contracts, with the exception of financial guarantee contracts, where ED 37 must be applied.

Elimination of alternative to treat financial guarantee contracts as insurance contracts

Financial guarantee contracts in the public sector are entered into frequently and give rise to the assumption of significant obligations. In the current economic environment, the issuance of financial guarantees by governments has increased because of the public sector's role as lender of last resort and its role in the stabilization of markets. It is therefore important that financial guarantees are accounted for transparently and consistently.

In the absence of an IPSAS equivalent of IFRS 4, ED 37 would refer entities to the international or national accounting standard dealing with insurance contracts in accordance with current IPSAS conventions. Staff has concerns that such an approach may result in some entities applying IFRS 4 and other entities adopting their own national requirements.

Including the alternative accounting treatment from IAS 32 in ED 37, given that no IFRS 4 equivalent exists, could potentially result in inappropriate and inconsistent accounting treatment for financial guarantee contracts.

As a result, Staff is of the view that it is appropriate to mandate a definitive accounting treatment for financial guarantee contracts, in the absence of an IPSAS equivalent for IFRS 4, and propose that all financial guarantee contracts be accounted for as financial instruments.

Financial instruments that are insurance contracts that transfer financial risk

In the absence of an IPSAS equivalent of IFRS 4, Staff is of the view that entities should be encouraged to apply ED 37 to financial instruments that are insurance contracts that involve the transfer of financial risk.

Financial risk is defined in IFRS 4 as “the risk of a possible 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 in the contract.”

IPSAS 15 states that all financial instruments that involve the transfer of financial risk should apply IPSAS 15, but that entities should consider applying IPSAS 15 to other insurance contracts.

As IAS 32 excludes all insurance contracts, it would be inconsistent to allow or encourage entities to apply IAS 32 to insurance contracts other than those that result in the transfer of financial risk.

Staff proposes that entities may apply ED 37 to those financial instruments that are insurance contracts that transfer financial risk. ED 37 reflects this in paragraph 3. However, in examining the definition of an insurance contract in IFRS 4, it is noted that “insured risks” exclude financial risks. As a result, Staff questions whether it may be more appropriate to be more prescriptive and require entities to apply ED 37 to those financial instruments that are insurance contracts that involve the transfer of financial risk.

Definition of an insurance contract

IFRS 4 was issued in March 2004 and post-dates IPSAS 15. For this reason Staff has incorporated the definition of an insurance contract from IFRS 4 in the Application Guidance. The definition was added in the Application Guidance rather than as a defined term in the text of the ED 37, as the IPSASB has not considered insurance contracts in the public sector and hence the inclusion of a defined term may be premature.

Issue 1 – Application of ED 37 to insurance contracts

- 1.1 Do you agree with the exclusion of insurance contracts (that transfer risks other than financial risks) from ED 37?
- 1.2 Do you agree with the proposal to treat financial guarantee contracts as insurance contracts?
- 1.3 With the exception of financial guarantee contracts, should ED 37 permit entities to apply ED 37 to financial instruments that are insurance contracts that involve the transfer of financial risk, or should entities be required to apply ED 37 to such contracts?
- 1.4 Do you agree with the inclusion of the definition of insurance contracts from IFRS 4 in the Application Guidance?

1.2 Distinguishing contractual and non-contractual financial guarantees

During the consultation phase in December 2008 and January 2009, some Members indicated that some financial guarantees may be non-contractual. Staff requested additional information on ‘non-contractual’ guarantees. Examples of such non-contractual guarantees in New Zealand are:

- Crown requirements to meet any shortfall incurred by the agency with the responsibility to deal with major natural disasters;
- Indemnities to magistrates for costs and damages awarded against them as a result of their exceeding their jurisdiction; and
- Indemnities to financial regulators with investigating powers.

A financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtors fails to make payment when due in accordance with the original or modified terms of a debt instrument. Staff highlighted two issues that may cause entities to deem certain financial guarantees non-contractual rather than contractual.

Staff developed additional Application Guidance to assist readers of ED 37 in identifying contractual financial guarantees. Staff also developed additional Application Guidance on identifying contractual and non-contractual arrangements for the purposes of applying the definition of a financial instrument (see section 2.1 below).

Staff highlighted two public sector issues on which further guidance is provided to enable users to determine whether ED 37 should be applied to a particular arrangement. .

Firstly, the right of government to issue financial guarantees is often granted in statute, legislation or similar means. This should be ignored in considering whether or not the agreement with the holder of the guarantee is contractual in nature.

Secondly, guarantees may be issued to a specific party e.g. government issues a guarantee to a financial institution guaranteeing the debt of one of its GBE's; or guarantees may be issued to a holder of an instrument e.g., the holder of a bond where the government has guaranteed the bond issue. In either scenario, guarantees would be considered contractual (assuming that the other features of a contractual arrangement exist).

Staff has reservations whether the type of non-contractual guarantees highlighted in the New Zealand examples should be within the scope of ED 37. Apart from the obvious point that they are non-contractual, they do not relate to a debt instrument. While a very narrow application of the definitions in IAS 32 and IAS 39 might neglect significant public sector transactions, the application of ED 37 to transactions which are both non-contractual and unrelated to a debt instrument is too remote from the transactions that IAS 32 and IAS 39 are dealing with. Therefore, Staff does not think that extending the Application Guidance to such guarantees would be in accordance with the directions given in Zurich. Staff considers it more appropriate for guarantees that do not relate to a debt instrument to be dealt with in accordance with IPSAS 19, Provisions, Contingent Liabilities and Contingent Assets" or international or national Standards dealing with insurance.

Issue 2 – Identifying contractual financial guarantees

Do you agree with the staff assessment of when financial guarantees could be considered contractual (AG3-AG4)?

Key Area 2. Definitions

2.1 Contractual versus non-contractual arrangements

During the consultation phase, a Member put forward a view that certain ‘non-contractual’ arrangements should be included within the scope of the EDs dealing with financial instruments because of the legal context in particular jurisdictions. In some jurisdictions, transactions between the government and the private sector are concluded by issuing ‘orders’ rather than entering into contracts, because government is legally incapable of entering into formal contracts. The substance of the arrangement is, however, that it is contractual in nature.

Arrangements involving the issuing of ‘orders’ typically involve a bidding process between the government and a counter- party, (usually the private sector), for a specific contract. This process will ultimately result in an exchange transaction. The only difference between a contractual arrangement and an arrangement that arises from the issuing of ‘orders’, is the legal position of the private sector counter-party. If the private sector counter-party performs on the basis of an ‘order’ rather than a contract it cannot take the case to an independent court of law, but has to appeal to the superior body of the entity making the order in the event of any dispute.

Rather than referring to specific arrangements in jurisdictions, Staff has developed additional Application Guidance describing the key features of a contractual arrangement. Entities in each jurisdiction can then apply these criteria in assessing whether arrangements are contractual or not in accordance with local circumstance.

The Application Guidance highlights the following three features:

- Parties enter into the transaction willingly. Therefore arrangements that compel entities to transact with one another are not contractual in nature;
- Rights and obligations are created for each party to the arrangement, although performance under the arrangement may not be equal for each party i.e., even though some of the parties may not give approximately equal value to other parties (non-exchange transaction), this does not make the arrangement non-contractual; and
- The arrangement is enforceable by law or equivalent means.

Issue 3: Distinguishing contractual and non-contractual arrangements

- (a) Do you agree with the Staff proposal to develop additional Application Guidance outlining the key features of a contractual arrangement?
- (b) Do you agree with the three key features proposed?

2.2 Definition of a financial asset – reference to ‘cash’

The definition of a financial asset includes: “A financial asset is any asset that is:

- (a) cash;
- (b) an equity instrument of another entity...”

Some Members expressed concern over the application of this definition to central banks and proposed that ‘cash’ be qualified by saying that it excluded cash, issued as legal tender by a central bank.

Rather than amend the definition, Staff proposes that the application of the definition be clarified through additional Application Guidance. As a result, AG8 was clarified to state that unissued currency of a central bank is accounted for in accordance with IPSAS 12, “Inventories”, while issued currency (notes and coins) is outside the scope of ED 37 and will be dealt with in any future project dealing with transactions entered into by central banks.

Issue 4: Definition of a financial asset

The Board is requested to **consider** Staff’s proposal for dealing with the application of the definition of a financial asset by central banks in paragraph AG8.

Key Area 3. Compound financial instruments

3.1 Component of net assets/equity versus net assets/equity component

In IAS 32 compound financial instruments contain both a liability component and an equity component. In current IPSAS terminology, ‘equity’ is termed ‘net assets/equity’. In the December version of IAS 32, Staff proposed to use the term a ‘component of net assets/equity’ rather than ‘net assets/equity component’ as Staff considered the latter wording awkward.

During the consultation process, some Members indicated their preference for the use of the term ‘net assets/equity component’. It was also suggested that the use of the term “component of net assets/equity” might alter the intention of the wording in IAS 32 because:

- (a) In IAS 32, both the liability and equity components are components of the compound financial instrument; while
- (b) The revised wording refers to a component of net assets/equity, which changes the meaning.

Staff has retained the original drafting, but requests the Board to reconsider the wording used in the light of comments received and provide a direction.

Issue 5: Component of net assets/equity v net assets/equity component

The Board is **requested** to re-consider the wording proposed in ED 37 when considering the components of a compound financial instrument, based on comment received, and **indicate** their preference for using:

- (a) A component of net assets/equity; or
- (b) A net assets/equity component.

3.2 Perpetual debt instruments: classification by the issuer

In the December version of ED 37, Staff had included perpetual debt instruments as an example of a compound financial instrument [paragraph 22(a)]. This example has been deleted from this version of ED 37, pending resolution of the issue outlined below.

The example noted that where contractual repayments existed, such as interest payments, these should be classified as a financial liability. Where no contractual repayments exist, such as for the capital, that portion should be classified as net assets/equity. Some Members did not agree with this proposal.

A financial liability is broadly defined as a contractual obligation to deliver cash or another financial asset to another entity. Equity instruments are described as any contract that evidences a residual interest in the assets of an entity after deducting its liabilities.

Financial liabilities are distinguished from equity instruments based on the existence of a contractual obligation to deliver cash or another financial asset. No such obligation exists for equity instruments.

Perpetual instruments may take various forms; some may include interest which is determinable throughout the life of the instrument, or for certain periods throughout the life of the instrument, while others may not provide for interest to be repaid. Additionally, the interest may or may not be market-related.

AG6 of IAS 32 only envisages a scenario where interest is paid throughout the life of a perpetual instrument, and the rate of interest is market-related. Given the different forms that perpetual instruments may take in the public sector, this guidance may not be sufficient. Additional Application Guidance may be required for situations where the perpetual instrument is not ‘market related’, as well as the classification of the ‘off-market’ portion of the instrument i.e. should it be classified as part of debt or net assets/equity?

Issue 6: Perpetual debt instruments

The Board is **requested** to consider whether additional Application Guidance is required for perpetual instruments that are not ‘market related’, including the classification of that off-market portion of the instrument as a liability or net assets/equity.

Key Area 4. Transitional provisions

4.1 Staff has proposed the following transitional provisions:

- ED 37 should be applied retrospectively. Previously Staff had proposed that comparative information need not be presented if such information is unavailable. Some Members believed that such relief is excessive, and may result in entities not attempting to prepare comparative information. As a result, the reference to comparative information was deleted. If entities are unable to apply ED 37 retrospectively, they should consider the guidance on “impracticability” in paragraphs 55-58 of IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors”;
- Entities that applied IPSAS 15 previously are exempted from applying the principles on puttable instruments retrospectively where the liability is no longer outstanding. This is similar to the transitional provision proposed in paragraph 97C of IAS 32; and.
- This transitional provision was expanded for those entities that apply IPSASs for the first time, or for those initially adopting accrual accounting. These entities need not apply the requirements in ED 37 to any compound financial instruments.

Staff was requested to consider whether it is necessary to develop transitional provisions for entities migrating from IAS 32 to ED 37. In identifying whether transitional provisions are necessary, it is important to highlight the differences between IAS 32 and ED 37. The most substantive difference is the treatment of financial guarantees as financial instruments and not insurance contracts. In Staff’s view, this is not an issue that warrants an additional transitional provision.

Issue 7: Transitional provisions

The Board is requested to **consider** whether:

- (a) The transitional provisions proposed in ED 37 are appropriate;
- (b) Additional transitional provisions are required for those entities migrating from an IFRS framework to IPSASs.

Key Area 5. Other issues

5.1 Interpretations

A decision is needed on how IFRIC 2 should be incorporated within the ED. Currently, IFRIC 2 has been included as an authoritative Appendix. Some members questioned whether it is appropriate to have two sets of authoritative guidance in an ED and proposed that the IFRIC be included in the Application Guidance.

Staff agrees that it appears peculiar and potentially confusing to have two sets of authoritative guidance. However, Staff has reservations about the incorporation of IFRIC

2 in the Application Guidance, because the Interpretation focuses in detail on a very specific issue. Inclusion in the Application Guidance would unbalance the document in relation to other issues discussed in the Application Guidance.

A further reason for including IFRIC 2 as a separate Appendix is that it also includes detailed, authoritative examples. Examples have not been included for other transactions dealt with in the existing Application Guidance.

Issue 8: Placement of Application Guidance

The Board is requested to **consider** whether the text from IFRIC 2 should be:

- (a) Retained as an authoritative appendix; or
- (b) Incorporated, along with its examples, into the existing Application Guidance.

5.2 Examples

There are two issues to consider in relation to examples. Firstly, staff has replaced the reference to ‘gold’ throughout ED 37 to ‘oil’. Some members expressed reservations whether there is a public sector reason to depart from IAS 32. In the context of IAS 32, gold is used to refer to a commodity. In the public sector context, gold may be a commodity or a currency. Given that the IPSASB plans to deal with monetary gold as part of a future project, Staff is of the view that the change is necessary.

Secondly, Illustrative Examples 7 and 8 from IAS 32 have been included in ED 37, although Staff has some reservations about the applicability of the examples to the public sector. Examples 7 and 8 provide illustrative financial statements for those entities, such as mutual funds and co-ops that do not have share capital. If these entities are not GBEs and apply IPSASs, Staff is of the view that sufficient guidance is provided in paragraph 95 of IPSAS 1 and that these Illustrative Examples are unnecessary.

Issue 9: Examples

The Board is requested to **consider** whether:

- (a) The replacement of ‘gold’ with ‘oil’ is appropriate; and
- (b) Illustrative Examples 7 and 8 should be retained or deleted.

Jeanine Poggiolini: Project Director, South African Accounting Standards Board
John Stanford: IPSASB Staff
Matthew Bohun-Aponte: IPSASB Staff

Cut & Paste of Comments on ED 37, “Financial Instruments: Presentation”

Key Issues (a) and (b)

Do you agree with the staff proposal to amend the scope of the Standard to:

1. Scope out all insurance contracts, except for financial guarantee contracts and derivatives included in the insurance contracts?
2. Permit entities to apply the Standard to financial instruments that are insurance contracts, which transfer financial risk between holder and issuer.

Greg Schollum (01)

I agree with the scope out of insurance contracts except financial guarantee contracts. However, what about financial guarantees provided by public entities other than by way of contract? The recent trend of Governments to grant guarantees (of a largely non-exchange nature) is likely to mean that they are not all contractual. The application guidance should make this clear.

I agree to permit entities to apply the standard to financial instruments that are insurance contracts which transfer the financial risk between the holder and issuer.

Rick Neville (02)

Yes (to both questions)

Stefan Berger (03)

Agree

Stuart Barr (04)

1. The rationale for scoping out insurance contracts from the ED seems to be based on the assumption that governments may be involved in insurance activities that generally are not undertaken by commercial insurance companies, with prices that are not determined in a competitive market and/or on a basis other than contractual arrangements such as statutory or other requirements.

To the extent that insurance contracts meet any or all of these criteria, I agree with the staff proposal to amend the scope of the Standard to scope them out of the ED (except for financial guarantee contracts and derivatives included in the insurance contracts).

However, to the extent that government enters into insurance contracts that are similar to those offered by private sector companies, I think we should consider requiring them to follow the same accounting standards as these companies unless there is a persuasive reason to the contrary. While there may be relatively few such insurance programs offered by entities following accounting standards for public sector entities, they do exist. Mortgage insurance in Canada, for example, is sold by both government and private sector entities.

I think as well that the scope exception paragraph 3.(c) for insurance contracts should specify, if IPSAS guidance exists, the guidance that applies to insurance contracts as it does for other exceptions in scope paragraph 3.

2. I agree that entities should be permitted to apply the Standard to financial instruments that are insurance contracts which transfer financial risk between the holder and issuer.

Ian Carruthers (05)

We agree with the staff proposals for insurance contracts and financial guarantee contracts.

Frans van Schaik (06)

1. It is unclear from the Standard why financial guarantee contracts are always within the scope of ED 37, while under IFRS the issuer has a choice regarding recognition and measurement of the contracts between IAS 39 (and therefore presentation according to IAS 32) and IFRS 4 (applicable in IPSAS through the hierarchy). The Basis of Conclusions might shed light on the public sector specific reason to maintain this deviation from IFRS.

2. It is unclear from the Standard why the Standard permits entities to apply the Standard to financial instruments that are insurance contracts which transfer financial risk between the holder and issuer. The Basis of Conclusions might shed light on the public sector specific reason to deviate from IFRS.

Peter Batten/Jim Paul (07)

Our comments on staff Questions 1 and 2 are provided together below.

As we understand it, the proposed differences between the scope of IAS 32 and the scope of the draft ED are that:

- whereas IAS 32 generally scopes out insurance contracts as defined in IFRS 4 *Insurance Contracts*, the draft ED would generally scope out insurance contracts as effectively defined in paragraph AG6 and discussed in paragraph AG7;
- whereas IAS 32 applies to financial guarantee contracts to which the issuer does not elect to apply IFRS 4 in recognising and measuring the contracts, the draft ED would apply to all financial guarantee contracts; and
- the draft ED may be applied to other financial instruments that take the form of insurance contracts that involve the transfer of financial risk (paragraph AG7 encourages such application)—IAS 32 is silent on this matter.

General scope-out of insurance contracts (Question 1)

In relation to the first of these points, the respective definitions of ‘insurance contract’ are:

- in IFRS 4: ‘a contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder’; and

- in the draft ED: ‘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’ (paragraph AG6).

Whilst the definition in the draft ED is more specific, in substance it seems highly similar to the definition in IFRS 4. We note the public sector specific issues mentioned in the second paragraph on page 3 of the covering memorandum. However:

- in view of the very broad nature of the definition of ‘insurance contract’ in IFRS 4, it is not apparent why IFRS 4 would be asserted to focus on insurance activities that are commercial, competitive products; and
- in relation to the point that insurance might be provided by a government not as a result of a contractual arrangement, this issue would seem to equally affect IAS 32 and the draft ED, because both apply only to *contracts*. Because non-contractual items fail the definition of a ‘financial instrument’ in IAS 32 (and the IPSASB has decided not to extend the definition of ‘financial asset’ to include particular non-contractual items), non-contractual insurance arrangements of public sector entities would need to be addressed in another IPSAS.

On the basis of these points, we see no public sector specific reason to base the general scope-out of insurance contracts on a different definition of ‘insurance contract’ than that in IFRS 4, and recommend that the definition of ‘insurance contract’ in IFRS 4 be added to the text of the draft ED.

Financial guarantee contracts (Question1)

We think the IPSAS based on IAS 32 should permit financial guarantee contracts to be accounted for as insurance contracts, notwithstanding that an IPSAS equivalent of IFRS 4 does not exist. IFRS 4 contains a limited range of requirements and permits the application of national accounting standards to various issues. The Introduction to IFRS 4 says the IASB issued IFRS 4 “to make limited improvements to accounting for insurance contracts until the Board completes the second phase of its project on insurance contracts” [paragraph IN1(a)].

We think that the objective of conforming with IAS 32 except where there are public sector specific reasons to depart would best be achieved by permitting financial guarantee contracts to be accounted for as insurance contracts under relevant international or national accounting standards, *provided that the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts under relevant international or national accounting standards*. The words in italics adapt the pre-requisite in paragraph 4(d) of IFRS 4 for applying that Standard to financial guarantee contracts. Such an election (to treat the contract either as an insurance contract or as a contract to which the Financial Instruments IPSASs apply) would need to be irrevocable, for consistency with IFRS 4, paragraph 4(d).

In relation to both issues discussed above, our preferred treatment would enable a non-GBE public sector entity to account for insurance contracts and financial guarantee

contracts similarly to a GBE applying IFRSs. We think this is an important objective, because the majority of public sector entities with insurance contracts would be GBEs, and GBEs and non-GBEs would be consolidated into whole-of-government financial statements using consistent accounting policies.

Insurance contracts involving the transfer of financial risk (Question 2)

In the absence of an IPSAS on Insurance Contracts, we have no objection to permitting or encouraging non-GBE public sector entities to apply the Financial Instruments IPSASs to other financial instruments that take the form of insurance contracts that involve the transfer of financial risk. This would not preclude an entity applying relevant international or national accounting standards for insurance contracts to those other financial instruments.

Key Issue (c) - Puttable instruments and obligations arising on liquidation and IFRIC 2

Do you agree with the treatment of the February 2008 amendments related to puttable instruments and obligations arising on liquidation and the inclusion of IFRIC 2 as an authoritative Appendix?

If Members, TAs and Observers are aware of examples of such situations in the public sector, please identify them for possible inclusion in Application Guidance.

Greg Schollum (01)

I agree

Rick Neville (02)

Yes; We are not aware of any such situations in the Public Sector

Stefan Berger (03)

Agree. We are not aware of any examples of such situations.

Stuart Barr (04)

I am not aware of any examples in Canada of government organizations that issue puttable instruments and obligations arising on liquidation.

Ian Carruthers (05)

We agree with the treatment of the Feb 2008 amendment, and the inclusion of IFRIC 2 as an authoritative Appendix.

We are not aware of any examples of such situations in the public sector

Frans van Schaik (06)

Agree. Please note however that the public sector include GBEs. The examples of puttable instruments and obligations arising on liquidation does exist in the public sector, but only in GBEs, and therefore not within the scope of IPSAS.

Peter Batten/Jim Paul (07)

We agree with the treatment of the February 2008 amendments related to puttable instruments and obligations arising on liquidation.

We are neutral on whether IFRIC 2 should be included in the draft ED. We are unaware of any public sector co-operatives and similar entities in Australia. However, they might exist in other jurisdictions—if so, we would strongly support including IFRIC 2 in the draft ED. If that guidance were to be included, we would agree with treating it as an authoritative Appendix (i.e., Application Guidance, which forms part of the IPSAS).

Key Issue (d) - Transitional Provisions

1. Should entities that previously applied IPSAS 15 be provided relief for retrospective application of the requirements on puttable financial instruments and obligations arising on liquidation where the liability component is no longer outstanding?
2. Should this same concession be granted to entities that previously did not apply IPSAS 15 or that are adopting accrual accounting; and should this concession then only be for those puttable financial instruments described in paragraph 15-18 of the Standard, or should the concession be granted for all financial instruments that should have been separated or classified as equity instruments or financial liabilities?
3. Do you agree that the Standard should be applied retrospectively for those entities that did not apply IPSAS 15 or that are adopting accrual accounting for the first time, with relief from providing comparative information where such information is not available?
4. Is there a need to provide additional relief in the transitional provisions for other areas?

Greg Schollum (01)

I agree.

Rick Neville (02)

- d 1) - Yes;
- d 2) - Yes; It should be granted for all financial instruments that should have been separated or classified as equity instruments or financial liabilities;
- d 3) - Yes;
- d 4) - No....none that we are aware of;

Stefan Berger (03)

- d 1) - Yes;
- d 2) - Yes;
- d 3) - Agree
- d 4) - I see no need for additional relief

Stuart Barr (04)

1 & 2. As I am not aware of any examples in Canada of government organizations that issue puttable instruments and obligations arising on liquidation, I do not have any views to contribute with respect to this issue.

3. Yes, I agree that the Standard should be applied retrospectively for those entities that did not apply IPSAS 15 or that are adopting accrual accounting for the first time, with relief from providing comparative information where such information is not available subject to the following. “Not Available” means more than simply the comparative information was not already determined in previous reporting periods but should mean that it cannot be determined after the preparer has made every reasonable effort to do so.

4. I am not aware of any need to provide additional relief in the transitional provisions for other areas.

Ian Carruthers (05)

We agree with the staff proposals to allow the reliefs embodied within the amended IAS 32, and to allow certain reliefs for comparative information.

We have not identified a need for other reliefs.

Frans van Schaik (06)

1. Yes.

2. This same concession should be granted to entities that previously did not apply IPSAS 15 or that are adopting accrual accounting. This concession should be granted for all financial instruments that should have been separated or classified as equity instruments of financial liabilities.

3. Yes

4. No

Peter Batten/Jim Paul (07)

d1) We think that entities that previously applied IPSAS 15 should be provided relief from retrospective application of the requirements on puttable financial instruments and obligations arising on liquidation where the liability component is no longer outstanding. Such relief would involve additional text to that in the Transitional Provisions (paragraph 56) in the draft ED.

d2) We think the same concession as that in Issue (d)1. should be granted to entities that previously did not apply IPSAS 15 or are adopting accrual IPSASs for the first time (i.e., all entities should qualify for the same relief). We think the concession should be available for all financial instruments for which a liability component no longer exists.

d3) We agree that the IPSAS should be applied retrospectively for all entities, and that relief from retrospective application should apply to entities that did not apply IPSAS 15 or are adopting accrual IPSASs for the first time.

We think this relief from retrospective application should apply to the extent that retrospective application is impracticable, consistent with the IFRS-converged principle

established in paragraphs 28-32 of IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors*. We would expect such relief to be available in the same circumstances in which comparative information is unavailable (the criterion proposed in your covering memorandum), and therefore see no need to change from the criterion in IPSAS 3. Granting relief from retrospective application to the extent that retrospective application is impracticable would be consistent with the general principle applying to *all* entities in IPSAS 3. Accordingly, we would see no need to limit such relief to entities that did not apply IPSAS 15 or are adopting accrual IPSASs for the first time.

d4) We are not aware of a need for any additional relief in the transitional provisions. However, we think that in developing the transitional provisions the staff should for the sake of completeness have considered a fourth scenario, that of entities that had used the framework to apply IAS32/39.

Key Issue (e) - Early adoption of the IPSASs relating to financial instruments

Do you agree that if an entity adopts one of the IPSASs relating to financial instruments early, it must adopt all the IPSASs relating to financial instruments early?

Greg Schollum (01)

I agree.

Rick Neville (02)

Yes

Stefan Berger (03)

Agree

Stuart Barr (04)

Response – Yes, I agree.

Ian Carruthers (05)

We agree that the suite of IPSASs relating to financial instruments should be adopted as a consistent set of guidance, rather than allowing piecemeal adoption.

Frans van Schaik (06)

Agree

Peter Batten/Jim Paul (07)

We agree that if an entity adopts early one of the IFRS-converged IPSASs on financial instruments, it must adopt all of the other IFRS-converged IPSASs on financial instruments at the same time.

Key Issue (f) - Compound Financial Instruments

Are there any additional examples of compound financial instruments that can be added to the Application Guidance, or further amendments that should be made to paragraphs AG53- AG58?

Greg Schollum (01)

There are compound financial instruments in the public sector context such as redeemable preference shares (which have components of debt and equity). However, typically these are found in GBEs which should not be following IPSAS.

Probably the best example I can think of in the public sector (excluding GBEs) would be suspensory loans. Often these don't appear to be compound financial instruments in form, but are in substance.

The recipient of a suspensory loan will typically have an element of the loan which is a liability and an element which is equity (contribution from owner).

Rick Neville (02)

No....none that we are aware of.

Stefan Berger (03)

Switzerland is newly involved in a bond convertible with UBS (Bank). We have asked external consultants to how account for this in the Annual Report. Decision is pending.

Stuart Barr (04)

I am not aware of any additional examples of compound financial instruments that can be added to the Application Guidance, or further amendments that should be made to paragraphs AG53- AG58.

Ian Carruthers (05)

We have not identified any additional examples or further amendments that should be made.

Frans van Schaik (06)

No additional examples of compound financial instruments. No further amendments to paragraphs AG53-AG58.

We prefer the wording 'net assets/equity component' over 'component of net assets/equity' because of its similarity to 'liability component.'

Peter Batten/Jim Paul (07)

We are not aware of any additional examples of compound financial instruments to add to the Application Guidance.

We agree with the general approach taken in paragraphs AG53-AG58.

Other Issues

Greg Schollum (01)

Definition of Financial asset	I think it is important to qualify the definition of financial asset as follows: as cash, <u>except when issued as legal tender by the issuer</u> (or words to that effect). This should avoid inappropriate accounting by central banks around the world.
• AG 18	I suggest you delete ‘appropriations’ as it means different things in different jurisdictions. In New Zealand, for example, it means the authority to spend. I think it is important to clarify through this guidance that a number of things in the public sector are not contractual in nature and will, therefore, not meet the definition of a financial asset or financial liability. Also, although AG 18 refers readers to IPSAS 23, it is important to acknowledge that this only deals with initial recognition (at fair value). The real question of how to account thereafter is not dealt with yet, although it is likely to be dealt with by the IPSASB in the future.
• AG 23/ AG 24	I would prefer if the ‘substance’ of the arrangement was emphasized more in these two paragraphs.
• Amendments to other IPSASs	A1 – the marked up section should refer to IPSAS <u>XX</u> (15) shouldn’t it?

Stefan Berger (03)

Paragraph 13	Is it necessary to mention ... "a financial asset" ...? From the <u>issuer</u> standpoint I see only a financial liability or an equity instrument.
Paragraph 27	the contract is a financial asset or a financial liability. My understanding says so.
Paragraph 29	... is a financial asset or a financial liability. My understanding says so.
Paragraph 31	... is a financial asset or a financial liability ... My understanding says so.
Paragraph 32such contracts are financial assets or financial liabilities ... My understanding says so.
Paragraph 33	: ... as financial liabilities, financial assets or equity instruments ... My understanding says so.
AG 17	First sentence: I guess this sentence is not complete.
AG 37	... paragraph 16A or paragraph 16C. To what is A and C referred?
Appendix B	Example 3: Paragraph 16 (a): Date = January 20X1, 1 (January, 1 20X1).

John Verrinder (08)

* Financial Guarantees: The new statistical standards (SNA 2008) differentiate between three different kinds of guarantees - (i) those which have the nature of financial derivatives, (ii) those which are standardised guarantees delivered through a scheme, and (iii) one-off guarantees. The guarantees under (ii) are to be treated in a very similar way to insurance. One of the main reasons for this is that for some schemes it is very hard to differentiate between insurance and guarantees, since they operate in concept in very similar ways. For example, public coverage for risks of export credit (very common in the EU) is variously known as "export credit guarantees" or "export credit insurance" across countries, even for the same type of scheme. We just wonder if at the margin very small administrative changes to a scheme could move it between insurance and financial guarantees, thereby leading to a different treatment?

* Puttable instruments: The definition in the ED is very helpful, and led us to think of three possible cases we have seen in the EU, though we're not quite sure if this is really what you are looking for:

- a) Convertible Bonds: At least one EU country has issued government bonds which are convertible into the shares of to-be-privatised public corporations.
- b) Privatisation vouchers: Used extensively in transition countries during mass privatisation, this involves issuing citizens with vouchers/ certificates which are convertible (at some point in the future) into the equity of privatised corporations.
- c) Compensation vouchers: Similar to privatisation vouchers above, we have seen at least two countries which recently issued these vouchers in settlement of claims for property seized in the past by the government. The vouchers give rights to receive the proceeds of a portfolio of equity of public corporations.

Peter Batten/Jim Paul (07)

Significant Concerns

Technical Matters of Disagreement or Uncertainty

Perpetual bond

We are concerned that the discussion of a perpetual bond in paragraph 22(a) is ambiguous and appears to be inconsistent with IAS 32, as exemplified by AG11.

The last sentence of paragraph 22(a) says 'To the extent that interest is required to be paid at regular intervals, a contractual obligation exists.' We read 'contractual obligation' as a reference to a financial liability. If that is the intended meaning, we recommend clarifying that by saying 'financial liability' instead of 'contractual obligation', given that:

- (a) paragraph 22 notes that the legal form of a financial instrument may differ from its substance (indicating that a contractual obligation might not be a liability); and
- (b) the other examples discuss whether a 'financial liability' or 'net assets/equity' exists.

Moreover, we are concerned that paragraph 22(a) says that ‘because (perpetual) bonds have no contractual redemption date, it is in substance similar to an equity instrument issued by an entity’. We interpret that comment as indicating that such bonds should be classified as equity instruments (this is implied, rather than said directly). Because the bond described in this subparagraph requires payment of interest at regular intervals, we think it should be classified as a financial liability.

Paragraph AG6 of the Application Guidance on IAS 32 says a ‘perpetual’ debt instrument with regular interest payments at a market rate of interest is a financial liability of the issuer.

Paragraph 22(a) of the draft ED implies that the perpetual bond is a compound instrument (as noted above, it also says that, ‘To the extent that interest is required to be paid at regular intervals, a contractual obligation exists’). However, paragraph 29 of IAS 32 specifies that, to be treated as a compound instrument, a financial instrument must grant an option to the holder of the instrument to convert it into an equity instrument of the entity. The facts described in paragraph 22(a) of the draft ED do not include a conversion option.

Conceivably, a perpetual bond could be issued at a below-market rate of interest, in which case the bond issue might be viewed as partly an exchange transaction and partly a non-exchange transaction. Although IAS 32 would not appear to permit separation of a perpetual bond into financial liability and net assets/equity components, it might be argued that a public sector specific reason exists to require such treatment in the related IPSAS. However, paragraph 22(a) does not contain such assumed facts. Therefore, on the basis of the facts presented, we think the perpetual bond should be classified wholly as a financial liability.

An instrument that is simultaneously a financial liability and net assets/equity

We disagree with the language used in paragraph AG25, third bullet point, to ‘Financial liabilities that in substance represent an interest in the net assets of an entity’. We think that if a financial instrument represents in substance an interest in the net assets of an entity, it would not be a financial liability. We recommend that consideration be given to replacing that bullet point with the following or similar wording (if we understand correctly the intended point):

‘Financial instruments in the legal form of debt that, in substance, represent an interest in the entity’s net assets’.

Exclusion of Examples 7 and 8 of the Illustrative Examples for IAS 32 from the Illustrative Examples for the draft ED

In the margin notes beside paragraph 22(b) and (c) of the draft ED, you note that Illustrative Examples 7 and 8 for IAS 32 have been excluded from the Illustrative Examples for the draft ED because:

- (a) these examples merely highlight the presentation of the statement of comprehensive income and financial position of entities that do not have “share capital”; and
- (b) ‘IPSAS 1 already provides sufficient guidance in this area (unlike the IFRS equivalent)’.

However, the guidance in those two examples is much more detailed than that provided in IPSAS 1. We note that these examples would probably be of very limited relevance to non-GBE public sector entities because they illustrate financial statement presentation for entities that have no equity and entities with share capital repayable on demand. Nevertheless, IFRIC 2 *Members’ Shares in Co-operative Entities and Similar Instruments* has been incorporated as Appendix B, even though that Interpretation would seem to have very limited application to non-GBE public sector entities. We have difficulty discerning the consistency of including IFRIC 2 but excluding Illustrative Examples 7 and 8. Therefore, on balance, we recommend including those Illustrative Examples.

Application Guidance on the applicability of the proposed IPSAS to investments in controlled entities, associates or joint ventures

We query the need for the new Application Guidance in paragraphs AG3 and AG4 because we do not think there is a public sector specific reason to add this guidance to the Application Guidance in IAS 32. The margin notes for paragraphs AG3 and AG4 indicate those paragraphs were added ‘to clarify revised scope requirements’. It is not apparent to us that the proposed amendments in scope paragraph 3(a) of the draft ED are substantive in nature. They seem to mainly reflect differences in document titles and terminology.

Matters of Presentation in the draft for review

As your covering memorandum says, the mark-ups are intended to show the proposed changes made to the current text of IAS 32. However, we note that:

- (a) various amendments made to IAS 32 during 2008 have been shown as mark-ups. We think this contradicts the general principle that mark-ups should only show the changes proposed to the current text of IAS 32 (i.e., the text at 31 December 2008) and therefore recommend not marking up those amendments. The text affected that we found is in paragraphs:

- 9 [definition of ‘financial asset’, part (d)(ii); definition of ‘financial liability’, part (b)(ii) and following paragraphs thereof; and the definition of ‘puttable instrument’];
 - 14(b)(ii) and the last sentence of paragraph 14;
 - 15-20 (entire text other than changing to public sector expression);
 - 21 (in first sentence);
 - 22(c) [all mark-ups, including strike-throughs, other than those in the last sentence];
 - 23 (first sentence);
 - 26 (first line);
 - 27 (entire paragraph);
 - 28 (first sentence);
 - 30(c) [entire sub-paragraph];
 - AG26 (all changes starting with ‘some ...’ in the fourth line, except for the amended cross-reference);
 - AG 27 (first sentence); and
 - AG49(a), (b) and (c) [except for ‘instruments’ in (c)];
- (b) the entire text of Interpretation IFRIC 2 in Appendix B is presented as a mark-up. This means that additions for public sector reasons are indistinguishable from the text of IFRIC 2, and deletions are both struck through and underlined, which is difficult to read and potentially confusing. Whilst we note that IFRIC 2 is not presented within IAS 32, we think it would be better to identify this in the prefatory comments to the proposed IPSAS rather than by marking up the entire Appendix;
- (c) various paragraph numbers differ from those in IAS 32 without being marked up as such;
- (d) some mark-ups do not accurately reflect the changes proposed to IAS 32 (examples are set out in our editorial comments and minor editorial comments below—for example, see our editorial comments on paragraphs 96-100 of IAS 32); and
- (e) whilst paragraph AG50 is presented as a mark-up of the IAS 32 Application Guidance, we could not locate the ‘original’ text in the current text of IAS 32. We also question why this guidance was added in this location, given that the last sentence of paragraph AG50 refers to the classification of particular financial instruments in the consolidated financial statements of the group and paragraph AG52 specifically deals with treatment in consolidated financial statements. (Note also that, in the last sentence of paragraph AG50, ‘group’ should be amended to ‘economic entity’.)

We note the comment in the ‘Comparison with IAS 32’ that the proposed IPSAS ‘does not reflect amendments made to IAS 32 as a consequence of the revisions made to IAS 1’. Perhaps this might have been a factor in the differences (noted in various places below) between the text of IAS 32 as presented as the starting point in the draft ED and the current text of IAS 32 on the IASB website. However, we would not expect this to be a factor, because a decision not to adopt certain recent changes to IAS 32 should be reflected in the mark-ups, not in the text presented as that of IAS 32.

Major Editorial Comment

In the first sentence of paragraph 33, you propose amending ‘both a liability and an equity component’ (in IAS 32, paragraph 28) to ‘both a liability component and a component of net assets/equity’. In the right-hand (explanatory comments) column, you note the alternative suggested wording of ‘both a liability and a net assets/equity component’. We strongly prefer this alternative wording. Our concern with the wording marked up in paragraph 33 is that:

- (a) in IAS 32, both the liability and equity components are components of the compound financial instrument; whilst
- (b) the wording marked up in paragraph 33 refers to a component of net assets/equity, which changes the meaning.

We do not think there is a public sector reason to change the meaning of that phrase in IAS 32. Therefore, we think the proposed amendment should be limited adopting the IPSAS equivalent term for equity, as occurs in your abovementioned *alternative* suggested wording (which is also more succinct than your marked-up proposed wording).

Exposure Draft 37

March 2009

Comments are requested by July 31 2009

*Proposed International Public Sector Accounting
Standard*

Financial Instruments: Presentation

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, “Financial Instruments: Presentation”, for publication in March 2009. The proposals in this Exposure Draft 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 July 30, 2009. All comments will be considered a matter of public record. Comments should be addressed to:

Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street, 4th Floor
Toronto, Ontario M5V 3H2 CANADA

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

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

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~~International Public Sector Accounting Standards Board
International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, New York 10017 USA~~

~~This International Public Sector Accounting Standard was prepared by the International Public Sector Accounting Standards Board (IPSASB), an independent standard setting body within the International Federation of Accountants (IFAC). The objective of the IPSASB is to serve the public interest by developing high quality accounting standards for use by public sector entities around the world in the preparation of general purpose financial statements. This will enhance the quality and transparency of public sector financial reporting and strengthen public confidence in public sector financial management. This publication may be downloaded free of charge from the IFAC website: <http://www.ifac.org>. The approved text is published in the English language. The mission of IFAC is to serve the public interest, strengthen the worldwide accountancy profession and contribute to the development of strong international economies by establishing and promoting adherence to high quality professional standards, furthering the international convergence of such standards and speaking out on public interest issues where the profession's expertise is most relevant.~~

ACKNOWLEDGMENT

This International Public Sector Accounting Standard is drawn primarily from International Accounting Standard (IAS) 32, "Financial Instruments: Presentation" published by the International Accounting Standards Board (IASB). Extracts from IAS 32 are reproduced in this publication of the International Public Sector Accounting Standards Board of the International Federation of Accountants with the permission of the International Accounting Standards Committee Foundation (IASCF).

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OBJECTIVE

The objective of this Exposure Draft is to propose requirements for the classification of financial instruments, from the issuer's perspective, into financial assets, financial

liabilities and equity, and for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities.

REQUEST FOR COMMENTS

The IPSASB invites comments on all the proposals in the Exposure Draft. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

INTRODUCTION

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 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 and Purpose of the Exposure Draft

In early 2007, the IPSASB initiated, subsequent to its General Improvements Project completed in 2006, a continuous improvements project to update existing IPSASs to converge with the latest related IFRSs to the extent appropriate for the public sector.

Governments around the world have been extensively involved in providing financial support to financial institutions and other entities affected by the current global economic crisis. The IPSASB identified the need to provide appropriate accounting guidance to governments and their entities for these specific transactions. Consequently, it agreed to issue a suite of standards providing principles for the recognition, measurement, presentation and disclosure of financial instruments which would be drawn primarily from IAS 32, "Financial Instruments: Presentation", IAS 39 "Financial Instruments: recognition and Measurement" and IFRS 7, "Financial Instruments: Disclosure".

This Exposure Draft addresses the presentation of financial instruments, while IPSAS 15 addressed both the presentation and disclosure of financial instruments. The disclosure of financial instruments is now addressed in a separate Standard, ED 39 IPSAS XX, "Financial Instruments: Disclosure".

ED 37, "Financial Instruments: Presentation" is primarily drawn from IAS 32, "Financial Instruments: Presentation". It incorporates the guidance in IFRIC 2, "Members Shares in Co-operative Entities and Similar Instruments" as an authoritative appendix. Public sector specific issues are addressed through Application Guidance. This approach is in line with the IPSASB's strategy of converging IPSASs with IFRSs where appropriate.

Presentation of this Exposure Draft of IPSAS 15

It is proposed that ED 37 replaces, rather than amends IPSAS 15, rather than amending it. This is because of the extent of the changes made by the IASB to IAS 32 as part of the Improvements Project

~~in 2003, subsequent revisions as a result of amendments made to other IFRS and the issuance of IFRS 7. “ Thus a new Standard is being exposed rather than a mark up of the previous version of IPSAS 15.~~

~~REQUEST FOR COMMENTS~~

~~Comments are invited on the proposals in this Exposure Draft by Month, DD, YYYY. The IPSASB invites comments on all the changes proposed in the Exposure Draft, and would particularly welcome comments to the question set out in the “Specific Matter for Comment” section. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.~~

~~Specific Matter for Comment~~

~~The IPSASB would particularly value comments on the following:~~

~~{Question}~~

~~Do you agree with this proposal?~~

~~Please provide your rationale for agreeing or disagreeing with this proposal.~~

**INTERNATIONAL PUBLIC SECTOR ACCOUNTING
STANDARD ~~IPSAS XX~~**

FINANCIAL INSTRUMENTS: PRESENTATION

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International Public Sector Accounting Standard XX, “Financial Instruments: Presentation” (IPSAS XX) is set out in paragraphs 1–62~~9~~⁰. All the paragraphs have equal authority except as noted otherwise. ED 37 ~~IPSAS XX~~ 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.

Introduction

IN1. International Public Sector Accounting Standard (IPSAS) XX, “Financial Instruments: Presentation”, replaces IPSAS 15, “Financial Instruments: Presentation and Disclosure” (issued December 2001), and should be applied for annual reporting periods beginning on or after Month Day, Year. Earlier application of this Standard, simultaneously with ED 38 and ED 39, is encouraged.

Reasons for Replacing IPSAS 15

IN2. The International Public Sector Accounting Standards Board replaced IPSAS 15 to converge public sector accounting standards with International Financial Reporting Standards (IFRSs) private sector standards to the extent appropriate. In developing an IPSAS on the presentation of financial instruments a new equivalent of IPSAS 15, the IPSASB primarily drew upon used IAS 32, “Financial Instruments: Presentation” (issued in 2003) as amended as at December, 31 2008 and included the guidance in IFRIC 2, “Members Shares in Co-operative Entities and Similar Instruments” as an authoritative appendix. Any reRevisions made to IAS 32 up to the end of 2008-December, 31 2008 have been considered, except those relating to amendments made to IAS 1, “Presentation of Financial Statements” in September 2007.

IN3. In developing this Standard, the IPSASB has departed from IAS 32 only where a public sector specific reason exists; such variances are noted in the Comparison with IAS 32.

Changes from Previous Requirements

IN4. The main changes from IPSAS 15 (2001) are described below.

General

IN5. This Standard does not prescribe disclosure requirements for financial instruments. The disclosure requirements relating to financial instruments are included in ~~IPSAS XX~~ ED 39, “Financial Instruments: Disclosures”.

IN6. Application Guidance has been included as an appendix to ~~ED 37 IPSAS XX(4)~~, which is an integral part of the Standard. Application Guidance explains selected issues pertaining to the principles included in the main text of ~~ED 37 IPSAS XX(4)~~. Guidance on the application of the principles in this Standard to members’ shares in co-operative entities and similar instruments has been provided in an appendix to the Standard. This Guidance is based on IFRIC 2 and is an integral part of the Standard.

IN7. Additional illustrative examples have also been included as an appendix to ~~ED 37 IPSAS XX(4)~~. However, these illustrative examples are not authoritative and accompany, rather than form part of, ~~ED 37 IPSAS XX(4)~~.

Scope

IN8. The scope has been amended as follows:

- Only those interests in controlled entities, joint ventures and associates that are measured in an entity’s separate financial statements using cost or the equity method are excluded from the scope of ~~ED 37 IPSAS XX(4)~~. Derivatives linked to interests in controlled entities, joint ventures and associates are however included in the scope of ~~ED 37 IPSAS XX(4)~~.
- Insurance contracts are excluded from the scope of ~~ED 37 IPSAS XX(4)~~, except:
 - Derivatives embedded in insurance contracts, if ~~ED 38 IPSAS XX~~, “Financial Instruments: Recognition and Measurement” requires that they be accounted for separately.
 - Financial guarantee contracts issued by an entity.
 - Certain elements of insurance contracts that contain a discretionary participation feature, including any derivatives embedded in such contracts.

Entities are encouraged to apply this Standard to financial instruments that take the form of insurance contracts that involve the transfer of financial risk.

- Share based payment transactions are excluded from the scope of ED 38 except:

- 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; and-
- Treasury shares purchased, sold, issued or cancelled.

Principle

IN9. 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 are 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 entity's own equity instruments do not include puttable financial instruments classified as equity instruments, instruments that impose on the entity an obligation to deliver to another party a pro-rata share of the net assets of the entity only on liquidation and are classified as equity instruments, or 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.

IN10. 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.

IN11. 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

IN12. 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 IN9 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 (for example, a commodity price), the contract is not an equity instrument, but is a financial asset or a financial liability.

Puttable Instruments

IN13. 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, except if the instrument has certain features. Where certain features are evident in a puttable financial instrument, it is treated as an equity instrument and not a financial asset or a financial liability.

Obligations Arising on Liquidation

IN14. Some instruments impose an obligation on an entity to deliver a pro rata share of the net assets of that entity to another party only on liquidation. In certain instances, these instruments are classified as equity instruments rather than financial liabilities.

Contingent Settlement Provisions

IN15. 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

IN16. 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 of the settlement alternatives would result in it being an equity instrument.

Measurement of the Components of a Compound Financial Instrument on Initial Recognition

IN16. Previously, IPSAS 15 allowed entities to measure the liability component of a compound financial instrument on initial recognition either as a residual amount after separating the equity component, or by using a relative-fair-value method. [ED 37 IPSAS XX](#) prescribes that any asset and liability components are separated first and the residual is the amount allocated to the component of net assets/equity. These requirements for separating the components of a compound financial instrument are conformed to both the definition of an equity instrument as a residual [and the measurement requirements in ED 38](#).

Treasury Shares

IN17. [Treasury shares arise when an entity re-acquires its own equity instruments. ED 37 IPSAS XX](#) clarifies that 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 or Similar Distributions, Losses and Gains

IN18. Transaction costs incurred as a necessary part of completing transactions in an entity's net assets/equity are accounted for as part of that transaction and are deducted from net assets/equity.

PROPOSED INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD ED 378 FINANCIAL INSTRUMENTS: PRESENTATION

Objective

- | | | | |
|----|---|--|--|
| 1. | [deleted] | <p>The objective of this Standard is to establish principles for presenting financial instruments as liabilities or <u>net assets/equity</u> and for offsetting financial assets and financial liabilities. It applies to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and equity instruments; the classification of related interest, dividends <u>or similar distributions</u>, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset.</p> | <p><u>IAS 32.1; paragraph deleted from IAS 32.</u></p> |
| 2. | <p>The principles in this Standard complement the principles for recognizing and measuring financial assets and financial liabilities in <u>ED 38IPSAS-XX</u>, “Financial Instruments: Recognition and Measurement”, and for disclosing information about them in <u>ED 39IPSAS-XX</u>, “Financial Instruments: Disclosures”.</p> | <p>IAS 32.24; amended wording to align with terminology used in other IPSASs.</p> <p>IAS 32.3; amended referencing from IASs to IPSASs.</p> | |

Scope (see also paragraphs AG3-AG7)

- | | | | |
|----|---|---|---|
| 3. | <p><u>An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard to This Standard shall be applied by all entities to all types of financial instruments, except:</u></p> | <p>IAS 32.4; amended to add standard wording in IPSAS regarding the application of IPSAS by entities that apply accrual accounting.</p> | <p>IAS 32.4; amended to add standard wording in IPSAS regarding the application of IPSAS by entities that apply accrual accounting.</p> |
| | <p><u>(i)(a) Those interests in controlled entities—subsidiaries, associates or joint ventures that are accounted for in accordance with IAS 27 IPSAS 6, “Consolidated and Separate Financial Statements”, IAS 28 IPSAS 7, “Investments in Associates” or IPSAS 8, IAS 31 “Interests in Joint Ventures”. However, in some cases, IAS 27 IPSAS 6, IAS 28 IPSAS 7 or IAS 31 IPSAS 8 permits an entity to account for an interest in a controlled entity subsidiary, associate or joint venture as a financial instrument or using the equity method ED 38 IAS 39;. Where entities an entity accounts for an interest in a controlled entity, associate or joint venture as a financial instrument, in those cases, entities shall apply the requirements of this Standard. Entities shall also apply this Standard to all derivatives linked to interests in controlled entities subsidiaries, associates or joint ventures.</u></p> | <p>IAS 32.4; amendments made for references to IPSAS and not IASs; changed terminology from subsidiary to controlled entity; amended wording to include the treatment of interests in controlled entities, joint ventures and associates using the equity method.</p> <p>Amendments resulting from the 2007/08 Improvements Project have also been incorporated.</p> | |
| | <p><u>(i)(b) Employers’ rights and obligations under employee benefit plans, to which IPSAS 25, IAS 19 “Employee Benefits” applies.</u></p> | <p>IAS 32.4; amendments made for references to IPSAS and not IASs.</p> | |
| | <p>(c) [deleted]</p> | <p><u>IAS 32.4(c) deleted from IAS 32</u></p> | |
| | <p><u>(iii)(c) Obligations arising from insurance contracts. —as defined in the international or national accounting</u></p> | <p>IAS 32.4; based on comment received, retained wording of existing IPSAS 15 with</p> | |

~~standard dealing with IFRS 4 insurance contracts.~~
However, this Standard applies to:

~~a.(i)~~ **Financial guarantee contracts; and**

~~b.(ii)~~ **Derivatives that are embedded in insurance contracts if ED 389 IPSAS XX IAS 39 requires the entity to account for them separately. Moreover, an issuer shall apply this Standard to financial guarantee contracts if the issuer applies IPSAS XX IAS 39 in recognizing and measuring the contracts, but shall apply the international or national accounting standard dealing with insurance contracts IFRS 4 if the issuer elects, in accordance with paragraph 4(d) of IFRS 4, to apply that standard IFRS 4 in recognizing and measuring them.**

With the exception in (a) above, an entity may apply this Standard to other financial instruments that take the form of insurance contracts which involve the transfer of financial risk.

regards to the treatment of insurance contracts as the ~~IFRS 4 definition and scope of insurance contracts~~ are inappropriate for the range of insurance contracts issued in the public sector. IPSASB has not addressed insurance contracts in the public sector yet. Added existing guidance from IPSAS 15 and the definition of insurance contracts in IFRS 4 to the Aapplication Gguidance explaining this issue.

~~As a result of this amendment, a~~All financial guarantees are to be treated as financial instruments and not insurance contracts. See the Basis for Conclusions for supporting rationale.

Included existing paragraph 6 of IPSAS 15 as application guidance. This paragraph ~~however~~ encouraged entities to consider accounting for some insurance contracts as financial instruments, where the insurance contract involves the transfer of financial risk. Retained in ED 37 in the absence of an IPSAS on insurance contracts.

~~(iv)(d)~~ **Financial instruments that are within the scope of the international or national accounting standard dealing with insurance contracts IFRS 4 because they contain a discretionary participation feature. The issuer of these instruments is exempt from applying to these features paragraphs 13–37 and AG47–AG58 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 ED 389 IPSAS XX IAS 39).**

IAS 32.4; amendments made for references to IPSAS and not IASs.

~~(v)(e)~~ **Financial instruments, contracts and obligations under share-based payment transactions to which the international or national accounting standard dealing with share-based payments IFRS 2 Share-based Payment applies, except for:**

IAS 32.4; amendments made for references to IPSAS and not IASs.

~~a.(i)~~ **Contracts within the scope of paragraphs 4–6 of this Standard, to which this Standard applies;**

~~b.(ii)~~ **Paragraphs 38 and 39 of this Standard, which shall be applied to treasury shares purchased, sold, issued or cancelled in connection with employee share option plans, employee share purchase plans, and all other share-based payment arrangements.**

~~[Deleted]~~

Paragraphs 5–7 of IAS 32 deleted.

4. **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,**

IAS 32.8; no amendment.

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.

5. 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 profit 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 4 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.

IAS 32.9; reference to a 'dealer's margin' in paragraph 5 (c) is probably not appropriate as these situations are not likely to exist in the public sector. However, wording retained in line with recommendations of the Zurich meeting.

6. 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 5(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 entity's expected purchase, sale or usage requirements.

IAS 32.10; no amendment.

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

Added standard wording from IPSAS regarding the application of the standards to GBEs.

8. The Preface to International Public Sector Accounting Standards issued by the International Public Sector Accounting Standards Board (IPSASB) explains that GBEs apply International Financial Reporting Standards, which are issued by the International Accounting Standards Board

Added standard wording from IPSAS regarding the application of the standards to GBEs.

(IASB).

Definitions (see also paragraphs AG8–AG46)

9. 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.

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

A financial asset is any asset that is:

- (a) Cash;
- (b) An equity instrument of another entity;
- (c) A contractual right:
 - ~~(a)~~(i) To receive cash or another financial asset from another entity; or
 - (ii) To exchange financial assets or financial liabilities with another entity under conditions that are potentially favorable to the entity; or
- (d) 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 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 puttable financial instruments classified as equity instruments in accordance with paragraphs 15 and 16, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 17 and 18, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.

IAS 32.11; Changed ordering of definitions to be alphabetical. [in accordance with normal IPSASB drafting conventions.](#)

Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

A financial liability is any liability that is:

- (a) A 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 entity; or

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

~~(a)(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 puttable financial instruments classified as equity instruments in accordance with paragraphs 15 and 16, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 17 and 18, or instruments that are ~~themselves~~ contracts for the future receipt or delivery of the entity's own equity instruments.

Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraph 15 and 16 or paragraphs 17 and 18.

A puttable instrument is a financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset or is automatically put back to the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder.

Included definition of a puttable instrument as a result of amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

Terms defined in other International Public Sector Accounting Standards are used in this Standard with the same meanings as in those other Standards, and are reproduced in the Glossary of Defined Terms published separately.

Added standard wording to the definitions section.

10. The following terms are defined in paragraph ~~9X~~ of ~~IAS 39 ED 389~~ ~~IPSAS XX~~ and are used in this Standard with the meaning specified in that Standard.

IAS 32.12; amended referencing to IPSAS and amended for terminology used in ED 38.

- amortized cost of a financial asset or financial liability
- available-for-sale financial assets
- derecognizing
- derivative
- effective interest method
- financial asset or financial liability at fair value through ~~surplus or deficit~~ ~~profit or loss~~
- financial guarantee contract
- firm commitment
- forecast transaction

- hedge effectiveness
 - hedged item
 - hedging instrument
 - held-to-maturity investments
 - loans and receivables
 - regular way purchase or sale
 - transaction costs.
11. In this Standard, ‘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 by law. Contracts, and thus financial instruments, may take a variety of forms and need not be in writing. IAS 32.13; no amendment.
12. In this Standard, ‘entity’ includes public sector entities, individuals, partnerships, incorporated bodies, and trusts. ~~and government agencies.~~ IAS 32.14; amended ‘government agencies’ to ‘public sector entities’.

Presentation

Liabilities and Net Assets/Equity (see also paragraphs AG47–AG5248)

13. **The issuer of a financial instrument shall classify the instrument, or its component parts, on initial recognition as a financial liability, a financial asset or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial liability, a financial asset and an equity instrument.** IAS 32.15; no amendment.
14. When an issuer applies the definitions in paragraph 9 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. IAS32.16; no amendment.
Highlighted as part of the Application Guidance that these kinds of instruments are not likely to be common in the public sector.
- (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.
- (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 have all the features and meet the conditions described in paragraphs 15 and 16 or paragraphs 17
- Included amendments made to IAS 32 in

and 18, or instruments that are contracts for the future receipt or delivery of the issuer's own equity instruments.

February 2008 relating to puttable financial instruments and obligations arising on liquidation.

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. As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraph 15 and 16 or paragraphs 17 and 18.

Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

Puttable Instruments

15. A puttable financial instrument includes a contractual obligation for the issuer to repurchase or redeem that instrument for cash or another financial asset on exercise of the put. As an exception to the definition of a financial liability, an instrument that includes such an obligation is classified as an equity instrument if it has all of the following features:

IAS 32.16A - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

Amended for public sector terminology.

- (a) It entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation. The entity's net assets are those assets that remain after deducting all other claims on its assets. A pro rata share is determined by:
 - (i) Dividing the entity's net assets on liquidation into units of equal amount; and
 - (ii) Multiplying that amount by the number of the units held by the financial instrument holder.
- (b) The instrument is in the class of instruments that is subordinate to all other classes of instruments. To be in such a class the instrument:
 - (i) Has no priority over other claims to the assets of the entity on liquidation; and
 - (ii) Does not need to be converted into another instrument before it is in the class of instruments that is subordinate to all other classes of instruments.
- (c) All financial instruments in the class of instruments that is subordinate to all other classes of instruments have identical features. For example, they must all be puttable, and the formula or other method used to calculate the repurchase or redemption price is the same for all instruments in that class.
- (d) Apart from the contractual obligation for the issuer to repurchase or redeem the instrument for cash or another financial asset, the instrument does not include any contractual obligation to deliver cash or another financial asset to another entity, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity, and it is not a contract that will or may be settled in the entity's own equity instruments as set out in

subparagraph (b) of the definition of a financial liability.

- (e) The total expected cash flows attributable to the instrument over the life of the instrument are based substantially on the surplus or deficit ~~profit or loss~~, the change in the recognized net assets or the change in the fair value of the recognized and unrecognized net assets of the entity over the life of the instrument (excluding any effects of the instrument).

- 16. For an instrument to be classified as an equity instrument, in addition to the instrument having all the above features, the issuer must have no other financial instrument or contract that has:

- (a) Total cash flows based substantially on the surplus or deficit ~~profit or loss~~, the change in the recognized net assets or the change in the fair value of the recognized and unrecognized net assets of the entity (excluding any effects of such instrument or contract); and
- (b) The effect of substantially restricting or fixing the residual return to the puttable instrument holders.

For the purposes of applying this condition, the entity shall not consider non-financial contracts with a holder of an instrument described in paragraph 15 that have contractual terms and conditions that are similar to the contractual terms and conditions of an equivalent contract that might occur between a non-instrument holder and the issuing entity. If the entity cannot determine that this condition is met, it shall not classify the puttable instrument as an equity instrument.

IAS 32.16B - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

Amended for public sector terminology: profit or loss to 'surplus or deficit'.

Instruments, or components of instruments, that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation

- 17. Some financial instruments include a contractual obligation for the issuing entity to deliver to another entity a pro rata share of its net assets only on liquidation. The obligation arises because liquidation either is certain to occur and outside the control of the entity (for example, a limited life entity) or is uncertain to occur but is at the option of the instrument holder. As an exception to the definition of a financial liability, an instrument that includes such an obligation is classified as an equity instrument if it has all of the following features:

- (a) It entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation. The entity's net assets are those assets that remain after deducting all other claims on its assets. A pro rata share is determined by:

- ~~a.~~(i) Dividing the net assets of the entity on liquidation into units of equal amount; and
- ~~b.~~(ii) Multiplying that amount by the number of the units held by the financial instrument holder.

- (b) The instrument is in the class of instruments that is subordinate to all other classes of instruments. To be in such a class the instrument:

- ~~•~~(i) Has no priority over other claims to the assets of the

IAS 32.16C - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

No amendment.

entity on liquidation, and

- | ~~•(ii)~~ Does not need to be converted into another instrument before it is in the class of instruments that is subordinate to all other classes of instruments.
- | (c) All financial instruments in the class of instruments that is subordinate to all other classes of instruments must have an identical contractual obligation for the issuing entity to deliver a pro rata share of its net assets on liquidation.

18. For an instrument to be classified as an equity instrument, in addition to the instrument having all the above features, the issuer must have no other financial instrument or contract that has:

- | (a) Total cash flows based substantially on the surplus or deficit ~~profit or loss~~, the change in the recognized net assets or the change in the fair value of the recognized and unrecognized net assets of the entity (excluding any effects of such instrument or contract); and
- | (b) The effect of substantially restricting or fixing the residual return to the instrument holders.

For the purposes of applying this condition, the entity shall not consider non-financial contracts with a holder of an instrument described in paragraph 17 that have contractual terms and conditions that are similar to the contractual terms and conditions of an equivalent contract that might occur between a non-instrument holder and the issuing entity. If the entity cannot determine that this condition is met, it shall not classify the instrument as an equity instrument.

IAS 32.16D - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

Amended for public sector terminology: profit or loss to 'surplus or deficit'.

Reclassification of puttable instruments and instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation

19. An entity shall classify a financial instrument as an equity instrument in accordance with paragraphs 15 and 16 or paragraphs 17 and 18 from the date when the instrument has all the features and meets the conditions set out in those paragraphs. An entity shall reclassify a financial instrument from the date when the instrument ceases to have all the features or meet all the conditions set out in those paragraphs. For example, if an entity redeems all its issued non-puttable instruments and any puttable instruments that remain outstanding have all of the features and meet all the conditions in paragraphs 15 and 16, the entity shall reclassify the puttable instruments as equity instruments from the date when it redeems the non-puttable instruments.

IAS 32.16E - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

No amendment.

20. An entity shall account as follows for the reclassification of an instrument in accordance with paragraph 19:

- | (a) It shall reclassify an equity instrument as a financial liability from the date when the instrument ceases to have all of the features or meet the conditions in paragraphs 15 and 16 or paragraphs 17 and 18. The financial liability shall be measured at the instrument's fair value at the date of reclassification. The entity shall recognize in net assets/equity any difference between the

IAS 32.16F - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

Amended for public sector terminology: profit or loss to 'net assets/equity'

carrying value of the equity instrument and the fair value of the financial liability at the date of reclassification.

- (b) It shall reclassify a financial liability as an equity instrument from the date when the instrument has all of the features and meets the conditions set out in paragraphs 15 and 16 or paragraphs 17 and 18. An equity instrument shall be measured at the carrying value of the financial liability at the date of reclassification.

No Contractual Obligation to Deliver Cash or Another Financial Asset (paragraph 14(a))

21. With the exception of the circumstances described in paragraphs 15 and 16 or paragraphs 17 and 18, 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 financial assets or financial liabilities 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 declared, or distributions of the net assets/equity or other distributions of equity, 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.

IAS 32.17.Redrafted wording slightly to reflect the concept of 'returns of or on capital', while amending the references to 'dividends or similar distributions'.

Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

22. The substance of a financial instrument, rather than its legal form, governs its classification on the entity's statement of financial position ~~balance sheet~~. Substance and legal form are commonly consistent, but not always. Some financial instruments take the legal form of equity instruments ~~equity~~ but are liabilities in substance and others may combine features associated with equity instruments and features associated with financial liabilities. For example:

IAS 32.18; amended the word 'equity' to 'equity instrument' to be consistent with the remainder of the Standard, changed reference to net assets/equity.

~~Amended other terminology to be public sector specific e.g. balance sheet vs statement of financial position.~~

- ~~(i) A perpetual bond with the payment of interest at regular intervals. A bond takes the legal form of a debt instrument, but because these types of bonds have no contractual redemption date, it is in substance similar to an equity instrument issued by an entity. To the extent that interest is required to be paid at regular intervals, a contractual obligation exists.~~

~~Added an example of a perpetual bond; these instruments do exist (albeit in limited instances) in the public sector.~~

~~Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.~~

- ~~(j)(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.~~

~~Deleted references to example 7 and 8 as these have not been included in the Illustrative Examples. These examples merely highlight the presentation of the statement of comprehensive income and financial position of entities that do not have "share capital". IPSAS 1 already provides sufficient guidance in this area (unlike the IFRS equivalent).~~

- ~~(k)(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, except for those instruments classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18. The financial instrument is a financial liability 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. 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, except for those instruments classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18. 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, which results in the unitholders' or members' interests being classified as financial liabilities, except for those instruments classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18. - 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 equity (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 are part of an entity's net assets/meet the definition of net assets/equity and puttable instruments which are that do not (see Illustrative Example 8).

23. 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, except for those instruments classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18. For example:
 - (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.
24. 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:
 - (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

IAS 32.19; no amendment. Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

IAS 32.20~~19~~; no amendment.

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.

Although the entity does not have an explicit contractual obligation to deliver cash or another financial asset, the value of the share settlement alternative is such that the entity will settle in cash. In any event, the holder has in substance been guaranteed receipt of an amount that is at least equal to the cash settlement option (see paragraph 25).

Settlement in the Entity's Own Equity Instruments (paragraph 14(b))

25. 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 (for example, 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 barrels of oil ~~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.

IAS 32.21; amended example of gold to oil as the IPSASB will deal separately with gold as both a commodity and a currency in future financial instrument projects.
26. Except as stated in paragraph 27, 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 asset/equity. Any consideration paid (such as the premium paid for a purchased option) is deducted directly from net assets/equity. Changes in the fair

IAS 32.22; aligned terminology with other IPSASs.

Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

value of an equity instrument are not recognized in the financial statements.

27. If the entity's own equity instruments to be received, or delivered, by the entity upon settlement of a contract are puttable financial instruments with all of the features and meeting the conditions described in paragraphs 15 and 16, or instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation with all of the features and meeting the conditions described in paragraphs 17 and 18, the contract is a financial asset or a financial liability. This includes a contract that will be settled by the entity receiving or delivering a fixed number of such instruments in exchange for a fixed amount of cash or another financial asset. IAS 32.22A - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.
28. With the exception of the circumstances described in paragraphs 15 and 16 or paragraphs 17 and 18, 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 ~~ED 389 IPSAS XXI~~IAS 39, its fair value (the present value of the redemption amount) is reclassified from net assets/equity. Subsequently, the financial liability is measured in accordance with ~~ED 389 IPSAS XXI~~IAS 39. If the contract expires without delivery, the carrying amount of the financial liability is reclassified to net assets/equity. An entity's contractual obligation to purchase its own equity instruments gives rise to a financial 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 (for example, 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). IAS 32.23; aligned terminology with other IPSASs and amended referencing from IASs to IPSASs.
Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.
29. 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 ~~barrels of oil-ounces of gold~~. IAS 32.24; amended example of gold to oil as the IPSASB will deal separately with gold as both a commodity and a currency in future financial instrument projects..

Contingent Settlement Provisions

30. 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, IAS 32.25; deleted reference to 'net income' as this is not a measure used in the IPSASs. ~~added reference to~~replaced net income with surplus or deficit in accordance with standard IPSASB terminology.
Included amendments made to IAS 32 in

- | or the issuer's future revenues, ~~net income~~ **surplus or deficit** or debt-to-equity 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;
 - | (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; or
 - | (c) The instrument has all of the features and meets the conditions in paragraphs 15 and 16.

February 2008 relating to puttable financial instruments and obligations arising on liquidation.

Settlement Options

31. | **When a derivative financial instrument gives one party a choice over how it is settled (for example, 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.**
- IAS 32.26; ~~aligned text with terminology in other IPSASs~~ **no amendment.**
32. 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 4–6). Such contracts are financial assets or financial liabilities and not equity instruments.
- IAS 32.27; no amendment.

Compound Financial Instruments (see also paragraphs AG53–AG58 and Illustrative Examples ~~97–1210~~)

33. | **The issuer of a non-derivative financial instrument shall evaluate the terms of the financial instrument to determine whether it contains both a liability component and a component of net assets/equity ~~an equity component~~. Such components shall be classified separately as financial liabilities, financial assets or equity instruments in accordance with paragraph 13.**
- IAS 32.28; amended wording to address the issue of 'equity components' in the public sector. As an alternative, the following is suggested: ...whether it contains both a liability and a net assets/equity component ~~an equity component~~.
34. An entity recognizes separately the components of a financial instrument that (a) creates a financial liability of the entity and (b) grants an option to the holder of the instrument to convert it into an equity instrument of the entity. For example, a bond or similar instrument convertible by the holder into a fixed number of ordinary shares of the entity is a compound financial instrument. From the perspective of the entity, such an instrument comprises two components: a
- IAS 32.29; amended wording to address the issue of 'equity components' in the public sector.
As an alternative, the following is suggested: ...an entity presents the liability and net assets/equity components... ~~an equity component~~.

financial liability (a contractual arrangement to deliver cash or another financial asset) and an equity instrument (a call option granting the holder the right, for a specified period of time, to convert it into a fixed number of ordinary shares of the 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 ordinary shares, or issuing a debt instrument with detachable share purchase warrants. Accordingly, in all cases, the entity presents the liability component and the component of net assets/equity and equity components separately in its statement of financial position.

35. Classification of a convertible instrument into its the components liability and 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 way that might be expected because, for example, the tax consequences resulting from conversion may differ among holders. Furthermore, the likelihood of conversion will change from time to time. The entity's contractual obligation to make future payments remains outstanding until it is extinguished through conversion, maturity of the instrument or some other transaction.

IAS 32.30; redrafted sentence to reflect the notion of a component of net assets/equity rather than an 'equity component'. ~~convertible instruments having component parts.~~
36. ED 38 IPSAS XX IAS 39 deals ~~addresses~~ with the measurement of financial assets and financial liabilities. Equity instruments 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 into its equity and liability components, the component of net assets/equity 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 is included in the liability component unless it forms part of the component of net assets/equity other than the equity component (such as an equity conversion option) is included in the liability component. The sum of the carrying amounts assigned to the liability component and the component of net assets/equity equity 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.

IAS 32.31; amended wording to address the notion of net assets/equity components rather than issue of 'equity components' in the public sector; aligned terminology with other IPSASs.

~~Aligned text with other IPSASs; amended 'deals with' to 'addresses'.~~
37. Under the approach described in paragraph 36, the issuer of a bond convertible into ordinary shares first determines the carrying amount of the liability component by measuring the fair value of a similar liability (including any embedded non-equity derivative features) that does not have an associated component of net assets/equity equity component. The carrying amount of the equity instrument represented by the option to convert the instrument into ordinary shares is then determined by deducting the fair value of the financial liability from the fair value of the compound financial

IAS 32.32; amended wording to address the issue of 'equity components' in the public sector; changed other public sector terminology.

instrument as a whole.

Treasury Shares (see also paragraph AG59)

38. **If an entity reacquires its own equity instruments, those instruments ('treasury shares') shall be deducted from net assets/equity. No gain or loss shall be recognized in surplus or deficit ~~profit or loss~~ 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 economic entity consolidated group. Consideration paid or received shall be recognized directly in net assets/equity.** IAS 32.33; amendments made to text for public sector terminology.
39. The amount of treasury shares held is disclosed separately either in the statement of financial position or in the notes, in accordance with IPSAS 1 ~~IAS 1~~, "Presentation of Financial Statements". An entity provides disclosure in accordance with IPSAS 20, ~~IAS 24~~ "Related Party Disclosures" if the entity reacquires its own equity instruments from related parties. IAS 32.34; amendments made to text for public sector terminology.

Interest, Dividends or Similar Distributions, Losses and Gains (see also paragraph AG60)

40. **Interest, dividends or similar distributions, losses and gains relating to a financial instrument or a component that is a financial liability shall be recognized as revenue income or expense in surplus or deficit ~~profit or loss~~. Distributions to holders of an equity instrument shall be debited by the entity directly to net assets/equity, net of any related income tax benefit ~~(where appropriate)~~. Transaction costs incurred on transactions in net assets/equity of an equity transaction shall be accounted for as a deduction from net assets/equity, net of any related income tax benefit ~~(where appropriate)~~.** IAS 32.35; redrafted sentence relating to costs of an equity transaction and aligned terminology with other IPSASs.
41. The classification of a financial instrument as a financial liability or an equity instrument determines whether interest, dividends or similar distributions, losses and gains relating to that instrument are recognized as revenue income or expense in surplus or deficit ~~profit or loss~~. Thus, dividends or similar distributions ~~payments~~ on shares wholly recognized as liabilities are recognized as expenses in the same way as interest on a bond. Similarly, gains and losses associated with redemptions or refinancings of financial liabilities are recognized in surplus or deficit ~~profit or loss~~, whereas redemptions or refinancings of equity instruments are recognized as changes in net assets/equity. Changes in the fair value of an equity instrument are not recognized in the financial statements. IAS 32.36; aligned terminology with other IPSASs.
42. 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. Any related ~~The~~ transaction costs of an equity transaction are accounted for as a deduction from net assets/equity (net of any related income tax benefit) to IAS 32.37; wording amended to accommodate the notion of an 'equity transaction' in the public sector.

the extent they are incremental costs directly attributable to the ~~equity~~ transaction that otherwise would have been avoided. The costs of ~~an equity~~ such a transaction ~~in~~ that is abandoned are recognized as an expense.

43. Transaction costs that relate to the issue of a compound financial instrument are allocated to the liability component and the component of net assets/equity ~~equity 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.

IAS 32.38; amended wording to accommodate ‘equity components’; changed text to eliminate examples that are not public sector specific.
44. The amount of transaction costs accounted for as a deduction from net assets/equity in the period is disclosed separately under IPSAS 1. ~~IAS 1. The related amount of income taxes recognised directly in equity is included in the aggregate amount of current and deferred income tax credited or charged to equity that is disclosed under IAS 12 Income Taxes.~~

IAS 32.39; amended to incorporate public sector terminology; deleted references to income taxes as these transactions do not commonly occur in the public sector.
45. Dividends or similar distributions classified as an expense are presented in the statement of financial performance ~~may be presented in the statement of comprehensive income or separate income statement (if presented)~~ 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 ~~IAS 1~~ and ED 39 IPSAS XX IFRS 7.—In some circumstances, because of the differences between interest and dividends or similar distributions with respect to matters such as tax deductibility, it is desirable to disclose them separately in the statement financial performance ~~of comprehensive income or separate income statement (if presented). Disclosures of the tax effects are made in accordance with IAS 12.~~

IAS 32.40; amended to incorporate public sector terminology; deleted references to income taxes as these transactions do not commonly occur in the public sector. Drafted the document on the basis that a statement of comprehensive income as envisaged in the revisions to IAS 1 does not exist in IPSAS 1. IAS 32 prior to the IAS 1 revisions required recognition of dividends paid in the income statement.
46. Gains and losses related to changes in the carrying amount of a financial liability are recognized as revenue ~~income~~ or expense in surplus or deficit ~~profit or loss~~ 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 22(b)). Under IPSAS 1 ~~IAS 1~~ the entity presents any gain or loss arising from remeasurement of such an instrument separately in the statement of financial performance ~~comprehensive income~~ when it is relevant in explaining the entity’s performance.

IAS 32.41; amended to incorporate public sector terminology; drafted the document on the basis that a statement of comprehensive income as envisaged in the revisions to IAS 1 does not exist in IPSAS 1. IAS 32 prior to the IAS 1 revisions required recognition of such gains and losses in the income statement.

Offsetting a Financial Asset and a Financial Liability (see also paragraphs AG61 and AG62)

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

(a) **Currently has a legally enforceable right to set off the recognized amounts; and**

IAS 32.42; no amendment.

- (b) **Intends either to settle on a net basis, or to realize the asset and settle the liability simultaneously.**

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 (see ED 38 IPSAS XX IAS 39, paragraph 36XX).

48. This Standard requires the presentation of financial assets and financial liabilities on a net basis when 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. In other circumstances, financial assets and financial liabilities are presented separately from each other consistently with their characteristics as resources or obligations of the entity. IAS 32.43; no amendment.
49. Offsetting a recognized financial asset and a recognized financial liability and presenting the net amount differs from the derecognition of a financial asset or a financial liability. Although offsetting does not give rise to recognition of a gain or loss, the derecognition of a financial instrument not only results in the removal of the previously recognized item from the statement of financial position but also may result in recognition of a gain or loss. IAS 32.44; no amendment.
50. 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 between the three parties that clearly establishes the debtor's right of set-off. Because the right of set-off is a legal right, the conditions supporting the right may vary from one legal jurisdiction to another and the laws applicable to the relationships between the parties need to be considered. IAS 32.45; no amendment.
51. 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 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 intends 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 because the rights and obligations associated with the individual financial asset and financial liability remain unaltered. IAS 32.46; no amendment.

52. An entity's intentions with respect to settlement of particular assets and liabilities may be influenced by its normal operating business 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 paragraph ~~(XX)~~ 36 of ED 39 IPSAS XX ~~IFRS 7~~. IAS 32.47; slight wording amendments to reflect public sector terminology.
53. 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 treated as simultaneous only when the transactions occur at the same moment. IAS 32.48; no amendment.
54. The conditions set out in paragraph 47 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 (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 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 contract.
- IAS 32.49; no amendment.
55. 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 may be ~~are~~ commonly used ~~by financial institutions~~ to provide protection against loss in the event of bankruptcy or other circumstances that result in a counterparty being unable to meet its obligations. A master netting arrangement IAS 32.50; aligned terminology with changes made in paragraph 45. Added in "may be" as these arrangements are not commonly used by all entities. Such netting arrangements exist, therefore deleted references to financial institutions.

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-business~~. A master netting arrangement does not provide a basis for offsetting unless both of the criteria in paragraph 47 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 ~~(36)~~ of ED 39 IPSAS XX IFRS 7.

Transitional Provisions

- | | | |
|-----|--|---|
| 56. | <u>An entity shall apply this Standard retrospectively on first time application. However, where an entity previously did not apply IPSAS 15 (2001) or adopts accrual accounting for the first time, it need not present comparative information if such information is not available.</u> | Added transitional provision paragraph. Entities should apply the Standard retrospectively, with certain concessions made for those entities that previously did not apply IPSAS 15 or did not apply accrual accounting. This concession is based on the transitional provision in IPSAS 15 as well as previous versions of IAS 32. |
| 57. | <u>When an entity that previously applied IPSAS 15 applies the requirements in paragraphs 15 to 18X, an entity is required to split a compound financial instrument with an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation into a liability component and component of net assets/equity separate liability and equity components. If the liability component is no longer outstanding, a retrospective application of these requirements would involve separating two components of net assets/equity. The first component would be in accumulated surpluses and deficits and represent the cumulative interest accreted on the liability component. The other component would represent the original equity—component of net assets/equity. Therefore, an entity need not separate these two components if the liability component is no longer outstanding when the Standard is adopted.</u> | <u>Added transitional provision to provide entities relief relating to puttable instruments.</u> |
| 58. | <u>An entity that either previously did not apply IPSAS 15 or adopts accrual accounting for the first time, applies the transitional provision in paragraph 57 X to all compound financial instruments.</u> | <u>Added transitional provision to provide entities that move from a different reporting framework or basis of accounting additional relief for compound instruments.</u> |

Disclosure

~~[Deleted]~~

IAS 32 paragraphs 51-95 deleted.

Effective Date

- | | | |
|------|---|---|
| 597. | <u>An entity shall apply this International Public Sector Accounting Standard for annual financial statements covering periods beginning on or after Month, Day, Year. Earlier application is encouraged. If an entity adopts this Standard for a period beginning before Month, Day,</u> | Added standard wording included in IPSAS. |
|------|---|---|

Year, it shall disclose that fact.

6058.

An entity shall not apply this International Public Sector Accounting Standard before Month, Day, Year, unless it also applies ED 38IPSAS XX and ED 39IPSAS XX.

Added paragraph to explain the early adoption of the financial instrument standards as a package of Standards.

6159.

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.

Standard wording in IPSASs.

~~An entity shall apply this Standard for annual periods beginning on or after 1 January 2005. Earlier application is permitted. An entity shall not apply this Standard for annual periods beginning before 1 January 2005 unless it also applies IAS 39 (issued December 2003), including the amendments issued in March 2004. If an entity applies this Standard for a period beginning before 1 January 2005, it shall disclose that fact.~~

IAS 32.96: developed transitional provisions specifically for the IPSAS.

~~*Puttable Financial Instruments and Obligations Arising on Liquidation* (Amendments to IAS 32 and IAS 1), issued in February 2008, required financial instruments that contain all of the features and meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D to be classified as an equity instrument, amended paragraphs 11, 16, 17–19, 22, 23, 25, AG13, AG14 and AG27, and inserted paragraphs 16A–16F, 22A, 96B, 96C, 97C, AG14A–AG14J and AG29A. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies these changes for an earlier period, it shall disclose that fact and apply the related amendments to IAS 1, IAS 39, IFRS 7 and IFRIC 2 at the same time.~~

IAS 32.96A: developed transitional provisions specifically for the IPSAS.

~~*Puttable Financial Instruments and Obligations Arising on Liquidation* introduced a limited scope exception; therefore, an entity shall not apply the exception by analogy. Before paragraph 96, the heading is amended (new text is underlined). After paragraph 96, paragraphs 96A–96C are added. After paragraph 97B, paragraph 97C is added.~~

IAS 32.96B: developed transitional provisions specifically for the IPSAS.

~~The classification of instruments under this exception shall be restricted to the accounting for such an instrument under IAS 1, IAS 32, IAS 39 and IFRS 7. The instrument shall not be considered an equity instrument under other guidance, for example IFRS 2 *Share-based Payment*.~~

IAS 32.96C: developed transitional provisions specifically for the IPSAS.

~~This Standard shall be applied retrospectively.~~

IAS 32.97: developed transitional provisions specifically for the IPSAS.

~~IAS 1 (as revised in 2007) amended the terminology used throughout IFRSs. In addition it amended paragraph 40. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies IAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.~~

IAS 32.97A: developed transitional provisions specifically for the IPSAS.

~~IFRS 3 (as revised in 2008) deleted paragraph 4(c). An entity shall apply that amendment for annual periods beginning on or after 1 July 2009. If an entity applies IFRS 3 (revised 2008) for an earlier period, the amendment shall also be applied for that earlier period.~~

IAS 32.97B: developed transitional provisions specifically for the IPSAS.

~~When applying the amendments described in paragraph 96A, an entity is required to split a compound financial instrument with an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation into separate liability and equity components. If the liability component is no longer outstanding, a retrospective application of those amendments to IAS 32 would involve separating two components of equity. The first component would be in retained earnings and represent the cumulative interest accreted on the liability component. The other component would represent the original equity component. Therefore, an entity need not separate these two components if the liability component is no longer outstanding at the date of application of the amendments.~~

IAS 32.97C: developed transitional provisions specifically for the IPSAS.

Withdrawal and Replacement of IPSAS 15 (2001)

629. This Standard replaces IPSAS 15, “Financial Instruments: Presentation and Disclosure” issued in 2001.

Added standard wording. This may need to be amended depending on the decision to be taken in February 2009 regarding the withdrawal/replacement of IPSAS 15.

Withdrawal of pronouncements

98 ~~This Standard supersedes IAS 32 *Financial Instruments: Disclosure and Presentation* revised in 2000.¹~~

IAS 32.98; paragraph specific to IPSAS 15 included.

99 ~~This Standard supersedes the following Interpretations:~~

IAS 32.99; paragraphs not relevant to IPSASs

~~(a) SIC 5 *Classification of Financial Instruments—Contingent Settlement Provisions*;~~

~~(b) SIC 16 *Share Capital—Reacquired Own Equity Instruments (Treasury Shares)*; and~~

~~(c) SIC 17 *Equity—Costs of an Equity Transaction*.~~

100 ~~This Standard withdraws draft SIC Interpretation D34 *Financial Instruments—Instruments or Rights Redeemable by the Holder*.~~

IAS 32.100; paragraph not relevant to IPSAS

¹ In August 2005 the IASB relocated all disclosures relating to financial instruments to IFRS 7 *Financial Instruments: Disclosures*

Appendix A - Application Guidance

This appendix is an integral part of ED 37 ~~the Standard~~.

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| AG1 | This Application Guidance explains the application of particular aspects of the Standard. | IAS32.AG1; no amendment. |
| AG2 | The Standard does not deal with the recognition or measurement of financial instruments. Requirements about the recognition and measurement of financial assets and financial liabilities are set out in <u>ED 38</u> IPSAS XX <u>IAS 39</u> . | IAS32.AG1; amended referencing from IAS to IPSAS. |

Scope (paragraphs 3-6)

Investments in Controlled Entities, Associates or Joint Ventures

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| <u>AG3</u> | <u>IPSAS 6, “Consolidated and Separate Financial Statements”, allows an entity to measure its investment in a controlled entity, associate or joint venture in its separate financial statements either:</u>

<u>1. At cost;</u>
<u>2. Using the equity method; or</u>
<u>3. As a financial instrument.</u> | Added paragraph to clarify revised scope requirements. |
| <u>AG4</u> | <u>Where an entity elects to measure an investment in a controlled entity, associate or joint venture as a financial instrument, the requirements of this Standard apply.</u> | Added paragraph to clarify revised scope requirements. |

Financial Guarantee Contracts

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|------------|--|---|
| <u>AG3</u> | <u>Financial guarantee contracts are those contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original terms of a debt instrument. Governments may issue financial guarantees for a variety of reasons. —although They are mainly often issued to further a government’s policy objectives, for example, to create affordability in infrastructure projects and stabilize the financial market in times of distress. Governments and public sector entities may be granted the power to issue financial guarantees in terms of legislation or other authority. In assessing whether a guarantee is contractual or non-contractual, an entity distinguishes the right to issue the guarantee and the actual issue of the guarantee. The right to issue the guarantee in terms of legislation or other authority is non-contractual, while the actual issue of the guarantee should be assessed using the principles in paragraph <u>AG18X</u> (AG17) to determine whether the guarantee is contractual or non-contractual.</u> | <u>Added paragraph to clarify when financial guarantees are deemed to be contractual.</u> |
| <u>AG4</u> | <u>The issuing of financial guarantees in favor of a third party, whether explicitly or implicitly, may result in a contractual arrangement. Financial guarantees may be issued to a specific party or they may be issued to the holder of an instrument. Consider the following two examples:</u> | <u>Added paragraph to clarify when financial guarantees are deemed to be contractual.</u> |

- In a service concession arrangement, a government may issue a financial guarantee directly to the financiers of the transaction stating that, in the event of default, it would assume payment for any outstanding principal and interest payments of a loan. In this instance, the financial guarantee is explicitly issued in favor of an identified counterparty.
- Road authority A is responsible for constructing and maintaining a country's road infrastructure. It finances the construction of new roads by issuing long term bonds. National government A exercises its powers in legislation and guarantees the bond issue of road authority A. At the time the guarantee is issued, there are no specific counterparties that have been identified, rather the guarantee is implicitly issued in favor of the holders of a specific instrument

In both these scenarios, assuming that all the other features of a contract are met, the financial guarantee is contractual in nature.

Insurance Contracts

AG5. Some economic entities in the public sector may include entities that issue insurance contracts. Those entities are within the scope of this Standard, but the insurance contracts themselves are outside the scope of this Standard.

Added principles of existing paragraph 6 of IPSAS 15 to explain the application of the Standard to insurance contracts. However, paragraph 6 was split into ~~three~~ paragraphs.

AG6 For the purposes of this Standard, an insurance contract is a contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) if a specified uncertain future event (the insured 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.~~

Added principles of existing paragraph 6 of IPSAS 15 to explain the application of the Standard to insurance contracts. However, paragraph 6 was split into three paragraphs. Rather than include the IPSAS 15 description of an insurance contract, included definition of an insurance contract from IFRS 4.

AG7 Some financial instruments take the form of insurance contracts but principally involve the transfer of financial risks, such as market, credit, or liquidity risk. Examples of such instruments include financial guarantee contracts, reinsurance and guaranteed investment contracts issued by public sector ~~insurance~~ insurers and other entities. An entity is required to apply this Standard to financial guarantee contracts, and is encouraged to apply this Standard to other insurance contracts that involve the transfer of financial risk.

Added principles of existing paragraph 6 of IPSAS 15 to explain the application of the Standard to insurance contracts. However, paragraph 6 was split into three paragraphs, and excluded the text that dealt with the encouraged application of financial instruments to obligations arising from insurance contracts.

Clarified that this Standard is mandatory for financial guarantee contracts.

Definitions (paragraphs 9–12)

Financial Assets and Financial Liabilities

AG8 Currency (cash) is a financial asset because it represents the medium of exchange and is therefore the basis on which all

IAS32.AG3; clarified the application of this Standard to cash held by a central bank.;~~no~~

- transactions are measured and recognized 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. Unissued currency held by a central bank does not meet the definition of a financial instrument. An entity applies IPSAS 12, "Inventories" in accounting for any unissued currency. Currency that has been issued by a central bank, i.e. notes and coins in circulation, is not addressed in this Standard. ~~amendment.~~
- AG9 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: IAS32.AG4; deleted the word 'trade' receivables.
- (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).
- AG10 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 government bonds gives the holder the contractual right to receive and the issuer the contractual obligation to deliver government bonds, not cash. The bonds are financial assets because they represent obligations of the issuing government to pay cash. The note is, therefore, a financial asset of the note holder and a financial liability of the note issuer. IAS32.AG5; no amendment.
- AG11 '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 per cent applied to a stated par or principal amount of CU1,000. Assuming 8 per cent 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 a financial liability, respectively. IAS32.AG6; no amendment.
- A12 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 IAS32.AG7; no amendment.

payment of cash or to the acquisition or issue of an equity instrument.

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| AG13 | 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 IFRS 4. | IAS32.AG8; deleted reference to IFRS 4. |
| AG14 | Under IPSAS 13, "Leases" IAS 17 Leases a finance lease is 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 regarded as 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 regarded as a financial instrument and an operating lease is not regarded as a financial instrument (except as regards individual payments currently due and payable). | IAS32.AG9; amended references from IASs to IPSASs. |
| AG15 | 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. | IAS32.AG10; no amendment. |
| AG16 | 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. | IAS32.AG11; no amendment. |
| AG17 | <u>Assets and liabilities in the public sector arise out of both contractual and non-contractual arrangements. Assets and</u> | <u>IA 32.AG12; clarified that assets and liabilities can arise out of both contractual and</u> |

AG18

liabilities arising out of non-contractual arrangements are not financial assets or financial liabilities.

~~Liabilities or assets~~ Assets or liabilities ~~that are not contractual (such as income taxes collected by a Revenue Authority) that are created as a result of statutory requirements imposed by governments) and are not financial liabilities or financial assets. Accounting for income taxes is dealt with in IAS 12. Similarly, constructive obligations, as defined in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, do not arise from contracts and are not financial liabilities.~~

non-contractual arrangement, amended example to be appropriate to the public sector, and separated the discussion on statutory and constructive obligations.

Contractual arrangements, for the purposes of this Standard, are generally evidenced by the following (although this may differ from jurisdiction to jurisdiction):

- Contractual arrangements typically involve willing parties entering into an arrangement. This means that arrangements that compel parties to transact with one another, such as when a government levies taxes on its citizens, are non-contractual in nature.;
- The terms of the contract create rights and obligations for the parties to the contract, and those rights and obligations need not result in equal performance by each party. For example, a donor funding arrangement creates an obligation for the donor to transfer resources to the recipient in terms of the agreement concluded, and establishes the right of the recipient to receive those resources. These types of arrangements could be considered may be contractual even though the recipient did not provide equal consideration in return i.e. the arrangement does not result in equal performance by the parties; and.
- The contract is enforceable by law.

Income taxes levied by a government, along with other statutory receivables such as fines and appropriations, are accounted for in accordance with IPSAS 23, “Non-exchange Revenue (Taxes and Transfers)”.

Added paragraph to clarify what the features of a contractual arrangement in the public sector may constitute.

Added paragraph to clarify how statutory receivables are accounted for.

AG19

Non-contractual, non-exchange revenue transactions are initially recognized and measured in accordance with IPSAS 23, “Revenue from Non-Exchange Transactions (Taxes and Transfers)”. If non-exchange revenue transactions are contractual and otherwise meet the definition of a financial asset, the principles in this Standard are also applied. As noted in the previous paragraph, non-exchange revenue transactions generally arise from the exercise of statutory or similar rights. Some non exchange revenue transactions are however concluded by way of a contract, for example, arrangements to receive donor funding. The initial recognition and initial measurement of assets arising from non exchange revenue transactions is dealt with in IPSAS 23. However, to the extent that non-exchange revenue transactions are contractual, and otherwise meet the definition of a financial asset, the principles in this Standard are also applied.

Added paragraph to clarify that entities should also consider the requirements of this Standard for receivables arising from contractual non-exchange revenue transactions, specifically the classification thereof into either liabilities or residual interests; the accounting requirements for contractual and non-contractual non-exchange revenue transactions.

Note: This will require a consequential amendment to the text of IPSAS 23 dealing with this issue.

AG20

An entity would particularly consider the classification

Added paragraph to clarify that entities should

requirements of this Standard in determining whether an inflow of resources as part of a contractual non-exchange revenue transaction is in substance a liability or an equity instrument.

also consider the requirements of this Standard for receivables arising from contractual non-exchange revenue transactions, specifically the classification thereof into either liabilities or residual interests.

Note: A consequential amendment to the text of IPSAS 23 has been proposed dealing with this issue.

AG21 Statutory obligations can be accounted for in a number of ways:

4. Obligations to pay income taxes are accounted for in accordance with the international or national accounting standard dealing with income taxes.

5. Obligations to provide social benefits are accounted for in accordance with ~~an entity's stated accounting policies for such transactions, taking into account the requirements of paragraphs 12-15 of IPSAS 3 "Accounting Policies, Changes in Accounting Estimates and Errors" and IPSAS 19, "Accounting Policies, Changes in Accounting Estimates and Errors".~~

6. Other statutory obligations are accounted for in accordance with IPSAS 19, "Provisions, Contingent Liabilities and Contingent Assets".

Added paragraph to clarify how statutory obligations are accounted for. Text relating to the treatment of taxes taken from IAS 32.AG12.

AG22 Constructive obligations, as defined in IPSAS 19, also do not arise from contracts and are therefore not financial liabilities.

Text separated from original IAS 32.AG12.

Equity Instruments

AG23 It is not common for entities in the public sector to have contributed capital comprising equity instruments, for example, shares and other forms of unitized capital. Where entities do issue equity instruments, the ownership and use of those instruments may be restricted by legislation. For example, legislation may stipulate that shares in a public sector entity may only be owned by another public sector entity and may therefore not be used as consideration for the settlement of transactions.

Added paragraph to explain the use of equity instruments in the public sector.

AG24 Contributed capital in the public sector may also be evidenced by transfers of resources between parties. Transfers of resources that result in an interest in the net assets/equity of an entity are distinguished from other transfers of resources because they may be evidenced by the following:

- A formal designation of a transfer of resources (or a class of such transfers) by the parties to the transaction as forming part of an entity's net assets/equity, either before the contribution occurs or at the time of the contribution. For example, on establishing a new entity, the budget office of the department of finance may deem that the initial transfers of resources to an entity establish an interest in the net assets/equity of an entity rather than

IPSAS 23 acknowledges the different forms of 'capital' that exist in the public sector in paragraph 38. The two bullets in this paragraph have been drawn from IPSAS 23.38.

provide funding to meet operational requirements.

- A formal agreement, in relation to the transfer, establishing or increasing an existing financial interest in the net assets/equity of an entity that can be sold, transferred or redeemed.

• Even though transfers of resources may be evidenced by a designation or formal agreement, an entity assesses the nature of transfers of resources based on their substance and not merely their legal form.

AG25 For the purposes of this Standard, the term “equity instrument” may be used to denote the following:

- (a) • A form of unitized capital such as ordinary or preference shares;
- (b) • Transfers of resources (either designated or agreed as such between the parties to the transaction) that evidence a residual interest in the net assets of another entity; and/or
- (c) • Financial liabilities in the legal form of debt that, in substance, represent an interest in entity's ~~the~~ net assets of an entity.

Added paragraph to clarify that “equity instruments” refers to all instruments that evidence a residual interest in the net assets of an entity, including some liabilities.

Puttable Instruments

AG26 Where an entity's contributed capital is comprised of shares or ~~and~~ other forms of unitized capital, these instruments may take a number of forms, for Examples, of equity instruments include non-puttable ordinary shares, some puttable instruments (see paragraphs 15 and 16), some instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation (see paragraphs 17 and 18), some types of preference shares (see paragraphs AG47 and AG48), and warrants or written call options that allow the holder to subscribe for or purchase a fixed number of non-puttable ordinary 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 (except as stated in paragraph 27). However, if such a contract contains an obligation for the entity to pay cash or another financial asset (other than a contract classified as an equity instrument in accordance with paragraphs 15 and 16 or paragraphs 17 and 18), it also gives rise to a liability for the present value of the redemption amount (see paragraph AG49(a)). An issuer of non-puttable ordinary shares assumes a liability when it formally acts to make a distribution and becomes legally obliged to the shareholders to do so. This may be the case following the 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.

IAS32.AG13; redrafted slightly based on the previous paragraph.

Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation. Amended reference to “equity” to “an equity instrument”.

AG27 A purchased call option or other similar contract acquired by an entity that gives it the right to reacquire a fixed number of its own equity instruments in exchange for

IAS32.AG14; amended terminology to be public sector specific.

Included amendments made to IAS 32 in

delivering a fixed amount of cash or another financial asset is not a financial asset of the entity (except as stated in paragraph 27). Instead, any consideration paid for such a contract is deducted from net assets/equity. February 2008 relating to puttable financial instruments and obligations arising on liquidation.

The class of instruments that is subordinate to all other classes (paragraphs 15(b) and 16(b))

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| AG28 | One of the features of paragraphs 15 and 16 is that the financial instrument is in the class of instruments that is subordinate to all other classes. | IAS32.AG14A - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation. No amendment to text. |
| AG29 | When determining whether an instrument is in the subordinate class, an entity evaluates the instrument's claim on liquidation as if it were to liquidate on the date when it classifies the instrument. An entity shall reassess the classification if there is a change in relevant circumstances. For example, if the entity issues or redeems another financial instrument, this may affect whether the instrument in question is in the class of instruments that is subordinate to all other classes. | IAS32.AG14B - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation. No amendment to text. |
| AG30 | An instrument that has a preferential right on liquidation of the entity is not an instrument with an entitlement to a pro rata share of the net assets of the entity. For example, an instrument has a preferential right on liquidation if it entitles the holder to a fixed dividend on liquidation, in addition to a share of the entity's net assets, when other instruments in the subordinate class with a right to a pro rata share of the net assets of the entity do not have the same right on liquidation. | IAS32.AG14C - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation. No amendment to text. |
| AG31 | If an entity has only one class of financial instruments, that class shall be treated as if it were subordinate to all other classes. | IAS32.AG14D - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation. No amendment to text. |

Total expected cash flows attributable to the instrument over the life of the instrument (paragraph 15(e))

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| AG32 | The total expected cash flows of the instrument over the life of the instrument must be substantially based on the <u>surplus or deficit</u> profit or loss , change in the recognised net assets or fair value of the recognised and unrecognised net assets of the entity over the life of the instrument. <u>Surplus or deficit</u> Profit or loss and the change in the recognised net assets shall be measured in accordance with relevant <u>IPSASs</u> IFRSs . | AG32.AG14E - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation. Amended for public sector terminology. |
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Transactions entered into by an instrument holder other than as owner of the entity (paragraphs 15 and 17)

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|------|--|---|
| AG33 | The holder of a puttable financial instrument or an instrument that imposes on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation may enter into transactions with the entity in a role other than that of an owner. For example, an instrument holder also may be an employee of the entity. Only the cash flows and the contractual terms and conditions of the instrument that relate to the | AG32.AG14F - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation. <u>Amended for public sector terminology.</u> |
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instrument holder as an owner of the entity shall be considered when assessing whether the instrument should be classified as an equity instrument under paragraph 15 or paragraph 17.

AG34 An example is a limited partnership that has limited and general partners. Some general partners may provide a guarantee to the entity and may be remunerated for providing that guarantee. In such situations, the guarantee and the associated cash flows relate to the instrument holders in their role as guarantors and not in their roles as owners of the entity. Therefore, such a guarantee and the associated cash flows would not result in the general partners being considered subordinate to the limited partners, and would be disregarded when assessing whether the contractual terms of the limited partnership instruments and the general partnership instruments are identical.

AG35 Another example, is a ~~revenue or surplus or deficit profit or loss~~ sharing arrangement that allocates surpluses and deficits ~~profit or loss~~ to the instrument holders on the basis of services rendered or business generated during the current and previous years. Such arrangements are transactions with instrument holders in their role as non-owners and should not be considered when assessing the features listed in paragraph 15 or paragraph 17. However, ~~such profit or loss sharing~~ arrangements that allocate surpluses and deficits ~~profit or loss~~ to instrument holders based on the nominal amount of their instruments relative to others in the class represent transactions with the instrument holders in their roles as owners and should be considered when assessing the features listed in paragraph 15 or paragraph 17.

AG36 The cash flows and contractual terms and conditions of a transaction between the instrument holder (in the role as a non-owner) and the issuing entity must be similar to an equivalent transaction that might occur between a non-instrument holder and the issuing entity.

No other financial instrument or contract with total cash flows that substantially fixes or restricts the residual return to the instrument holder (paragraphs 16 and 18)

AG37 A condition for classifying an equity instrument ~~a financial instrument~~ as an equity instrument a financial instrument that otherwise meets the criteria in paragraph ~~15+6A~~ or paragraph ~~17+6C~~ is that the entity has no other financial instrument or contract that has (a) total cash flows based substantially on the surplus or deficit ~~profit or loss~~, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity and (b) the effect of substantially restricting or fixing the residual return. The following instruments, when entered into on normal commercial terms with unrelated parties, are unlikely to prevent instruments that otherwise meet the criteria in paragraph ~~15+6A~~ or paragraph ~~17+6C~~ from being classified as equity instruments:

- (a) Instruments with total cash flows substantially based on specific assets of the entity.

AG32.AG14G - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

AG32.AG14H - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

Amended terminology to be more public sector specific.

AG32.AG14I - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

AG32.AG14I - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

Amended for public sector terminology ~~wording to refer to an 'equity instrument'~~.

- (b) Instruments with total cash flows based on a percentage of revenue.
- (c) Contracts designed to reward individual employees for services rendered to the entity.
- (d) Contracts requiring the payment of an insignificant percentage of profit for services rendered or goods provided.

Derivative Financial Instruments

AG38 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. IAS32.AG15; no amendment.

AG39 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 contractual obligation to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavorable. However, they generally² do not result in a transfer of the underlying primary financial instrument on inception of the contract, nor does such a 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. IAS32.AG16; no amendment.

~~Have not included footnote relating to the transfer of the underlying primary instrument (e.g. cross currency interest rate swaps, principal is exchanged on inception)~~

AG40 A put or call option to exchange financial assets or financial liabilities (i.e. financial instruments other than an entity's own equity 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 forgo 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 IAS32.AG17; no amendment.

² 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).

would constitute a financial asset of the holder if the option were exercised. The option-holder's right to exchange the financial asset under potentially favorable conditions and the writer's obligation to exchange the financial asset under potentially unfavorable conditions are distinct from the underlying financial asset to be exchanged upon exercise of the option. The nature of the holder's right and of the writer's obligation are not affected by the likelihood that the option will be exercised.

- AG41 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 effect will be the opposite. The purchaser has 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. IAS32.AG18; no amendment.
- AG42 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. IAS32.AG19; no amendment.

Contracts to Buy or Sell Non-Financial Items (paragraphs 4-6)

- AG43 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, IAS32.AG20; amended example to be more public sector specific.

contracts that provide for settlement only by the receipt or delivery of a non-financial item (for example, an option, futures or forward contract on oil ~~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 bought and sold readily for cash because it is listed 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 4).

- | | | |
|------|--|---|
| AG44 | A contract that involves the 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. | IAS32.AG21; amendment of wording for the public sector. |
| AG45 | Some contracts are commodity-linked, but do not involve settlement through the 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. | IAS32.AG22; no amendment. |
| AG46 | The definition of a financial instrument also encompasses a contract that gives rise to a non-financial asset or non-financial liability in addition to a financial asset or financial 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 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. | IAS32.AG23; no amendment. |

~~Deleted~~

IAS 32.AG24: paragraph deleted from IAS 32.

Presentation

Liabilities and Net Assets/Equity (paragraphs 13-32)

No Contractual Obligation to Deliver Cash or Another Financial Asset (paragraphs 21-24)

- AG47 Preference shares may be issued with various rights. In determining whether a preference share is a financial liability or an equity instrument, an issuer assesses the particular rights attaching to the share to determine whether it exhibits the fundamental characteristic of a financial liability. For example, a preference share that provides for redemption on a specific date or at the option of the holder contains a financial liability because 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 preference share when contractually required to do so, whether because of a lack of funds, a statutory restriction or insufficient surpluses—profits 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 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.
- IAS32.AG25; clarified in paragraph AG 22 that the issue of equity instruments may not be common in the public sector, therefore only terminology amendments proposed to this paragraph.
- AG48 When preference shares are non-redeemable, the appropriate classification is determined by the other rights that 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 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:
- IAS32.AG26: aligned terminology with other IPSASs. :
- (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 on the ordinary shares if dividends 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 ~~profit or loss~~ for a period; or
 - (f) An ability or inability of the issuer to influence the amount of its surplus or deficit ~~profit or loss~~ for the period.

Settlement in the Entity's Own Equity Instruments (paragraphs 25-29)

AG49 As noted in paragraph AG23, it is not common for entities in the public sector to issue equity instruments comprising shares or other forms of unitized capital; and where such instruments do exist, their use and ownership is usually restricted in legislation. As a result of the capital structure of public sector entities generally being different from private sector entities and the legislative environment in which public sector entities operate, transactions that are settled in an entity's own equity instruments are not likely to occur as frequently in the public sector as in the private sector. However, where such transactions do occur, the following examples may assist in illustrating how to classifying different types of contracts on an entity's own equity instruments:

- (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 (except as stated in paragraph 27). Accordingly, any consideration received or paid for such a contract is added directly to or deducted directly from net assets/equity. 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 (with the exception of instruments that have all the features and meet the conditions in paragraph 15 and 16 or paragraphs 17 and 18). 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 (except as stated in paragraphs 15 and 16 or paragraphs 17 and 18). 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 equity instruments (except as stated in paragraphs 15 and 16 or paragraphs 17 and 18). One example is a net cash-settled share option.
- (d) A contract that will be settled in a variable number of

IAS32.AG27; clarified that these kinds of transactions are not common in the public sector; amended for public sector terminology and replaced "gold" with "oil".

Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

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 oil ~~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 oil ~~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.

AG50 ~~Some types of instruments that impose a contractual obligation on the entity are classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18. Classification in accordance with those paragraphs is an exception to the principles otherwise applied in this Standard to the classification of an instrument and cannot be applied by analogy to other instruments. This exception is not extended to the classification of non-controlling interests in the consolidated financial statements. Therefore, instruments classified as equity instruments in accordance with either paragraphs 15 and 16 or paragraphs 17 and 18 in the separate or individual financial statements that are non-controlling interests are classified as liabilities in the consolidated financial statements of the group.~~

~~Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.~~

~~Added wording from paragraph 96B of the amendments to IAS 32 (part of the transitional provisions), to clarify that the exceptions may not be applied to other transactions.~~

Contingent Settlement Provisions (paragraph 30)

AG51+ Paragraph 30 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.

IAS32.AG28; no amendment.

Treatment in Consolidated Financial Statements

AG512 In consolidated financial statements, an entity presents non-controlling interests—i.e. the interests of other parties in the net assets/equity and revenue income—of its controlled entities subsidiaries in accordance with IPSAS 1 IAS 1 and IPSAS 6 IAS 27. When classifying a financial instrument (or a component of it) in consolidated financial statements, an entity considers all terms and conditions agreed between

IAS32.AG29; aligned terminology with other IPSASs.

members of the ~~economic entity-group~~ and the holders of the instrument in determining whether the ~~economic entity-group~~ 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 subsidiary in a group~~ issues a financial instrument and a ~~controlling entity parent~~ or other ~~entity within the economic group~~ entity agrees additional terms directly with the holders of the instrument (for example, a guarantee), the ~~economic entity-group~~ may not have discretion over distributions or redemption. Although the ~~controlled entity subsidiary~~ 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-group~~ 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-group~~ 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.

AG52 Some types of instruments that impose a contractual obligation on the entity are classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18. Classification in accordance with those paragraphs is an exception to the principles otherwise applied in this Standard to the classification of an instrument and cannot be applied by analogy to other instruments. This exception is not extended to the classification of non-controlling interests in the consolidated financial statements. Therefore, instruments classified as equity instruments in accordance with either paragraphs 15 and 16 or paragraphs 17 and 18 in the separate or individual financial statements that are non-controlling interests are classified as liabilities in the consolidated financial statements of the economic entity group.

IAS 32.29A. Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

Added wording from paragraph 96B of the amendments to IAS 32 (part of the transitional provisions), to clarify that the exceptions may not be applied to other transactions by analogy. Amended for public sector terminology.

Compound Financial Instruments (paragraphs 33-37)

AG53 Paragraph 33 applies only to issuers of non-derivative compound financial instruments. Paragraph 33 does not deal with compound financial instruments from the perspective of holders. ~~ED 38-IPSAS XX IAS 39~~ addresses the separation of embedded derivatives from the perspective of holders of compound financial instruments that contain the features of both debt and equity instruments. ~~debt and equity features.~~

IAS32.AG30; amended referencing from IAS to IPSAS, and amended wording to accommodate the concept of “equity components” in the public sector.

AG54 Compound financial instruments are not common in the public sector because of the capital structure of public sector entities. The following discussion does however illustrate how a compound financial instrument would be analyzed into its component parts. A common form of compound financial instrument is ~~A~~ a debt instrument with an embedded conversion option, such as a bond convertible into ordinary shares of the issuer, and without any other embedded derivative features. ~~is an example of a~~

IAS32.AG31; added wording to clarify the compound financial instruments are not common in the public sector; amended wording to refer to components of net assets.

	<p>compound financial instrument. Paragraph 33 requires the issuer of such a financial instrument to present the liability component and <u>the component of net assets/equity component</u> separately in the statement of financial position, as follows:</p> <ul style="list-style-type: none"> •(a) The issuer's obligation to make scheduled payments of interest and principal is a financial liability that exists as long as the instrument is not converted. On 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 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 The-embedded option to convert the liability into <u>net assets/equity instruments</u> of the issuer. represents a component of net assets/equity. 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. 	
AG55	On conversion of a convertible instrument at maturity, the entity derecognizes the liability component and recognizes it as <u>net assets/equity</u> . The original equity component <u>of net assets/equity</u> remains as <u>net assets/equity</u> (although it may be transferred from one line item within <u>net assets/equity</u> to another). There is no gain or loss on conversion at maturity.	IAS32.AG32; aligned wording with other IPSASs.
AG56	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 equity 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 33-37.	IAS32.AG33; <u>deleted references to liability and equity components as the terminology used in this IPSAS is different (liability component and component of net assets/equity)</u> . <u>aligned wording with other IPSASs</u> .
AG57	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: <ul style="list-style-type: none"> •(a) The amount of gain or loss relating to the liability component is recognized in <u>surplus or deficit</u> profit or loss; and •(b) The amount of consideration relating to the <u>component of net assets/equity component</u> is recognized in <u>net assets/equity</u>. 	IAS32.AG34; aligned terminology with other IPSASs.
AG58	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	IAS32.AG35; no <u>amendment</u> <u>aligned terminology with other IPSASs</u> .

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 ~~profit or loss~~.

Treasury Shares (paragraphs 38 and 39)

AG59 An entity's own equity instruments are not recognized as a financial asset regardless of the reason for which they are reacquired. Paragraph 38~~2~~ requires an entity that reacquires its own equity instruments to deduct those equity instruments from net assets/equity. However, when an entity holds its own equity instruments on behalf of others, for example, a financial institution holding its own equity instruments 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.

IAS32.AG36; retained reference to 'equity instruments' as it is not likely that these transactions will take place with other forms of contributed capital.

Interest, Dividends or Similar Distributions, Losses and Gains (paragraphs 40–46)

AG60 The following example illustrates the application of paragraph 40 to a compound financial instrument. Assume that a non-cumulative preference share is mandatorily redeemable for cash in five years, but that dividends 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 ~~profit or loss~~ and classified as interest expense. Any dividends paid relate to the component of net assets/equity component and, accordingly, are recognized as a distribution of surplus or deficit ~~profit or loss~~. 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 (for example, a 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 expense.

IAS32.AG37; amended for public sector terminology; retained references to shares & dividends in instances throughout, as it is merely an example, to be consistent with the example used. Amended reference to dividends or similar distributions where used more generally.

Offsetting a Financial Asset and a Financial liability (paragraphs 47–55)

AG61 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.

IAS32.AG38; no amendment.

AG62 The Standard does not provide special treatment for so-

IAS32.AG39; no amendment.

called 'synthetic instruments', which are groups 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 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 financial instrument is exposed to risks that may differ from the risks to which other financial instruments are exposed. Accordingly, when one financial instrument in a 'synthetic instrument' is an asset and another is a liability, they are not offset and presented in an entity's statement of financial position on a net basis unless they meet the criteria for offsetting in paragraph 47.

Disclosure

~~Financial Assets and Financial Liabilities at Fair Value Through Profit or Loss~~ (paragraph 94(f))

~~Deleted~~

IAS 32.AG40; deleted from IAS 32.

Appendix B - Members' Shares in Co-Operative Entities and Similar Instruments

This appendix is an integral part of ED 37 the Standard.

Introduction

- 1 Co-operatives and other similar entities are formed by groups of persons to meet common economic or social needs. National laws typically define a co-operative as a society endeavouring to promote its members' economic advancement by way of a joint business operation (the principle of self-help). Members' interests in a co-operative are often characterised as members' shares, units or the like, and are referred to below as 'members' shares'. This Appendix applies to financial instruments issued to members of co-operative entities that evidence the members' ownership interest in the entity and does not apply to financial instruments that will or may be settled in the entity's own equity instruments.
- 2 ~~ED 37 IPSAS XX(15)~~ IAS 32 establishes principles for the classification of financial instruments as financial liabilities or net assets/equity. In particular, those principles apply to the classification of puttable instruments that allow the holder to put those instruments to the issuer for cash or another financial instrument. The application of those principles to members' shares in co-operative entities and similar instruments is difficult. This guidance is provided to illustrate the application of the principles in ED 37 ~~Some of the International Accounting Standards Board's constituents have asked for help in understanding how the principles in IAS 32 apply to members' shares and similar instruments that have certain features, and the circumstances in which those features affect the classification as liabilities or net assets/equity.~~

Scope

~~3 This Interpretation applies to financial instruments within the scope of IAS 32, including financial instruments issued to members of co-operative entities that evidence the members' ownership interest in the entity. This Interpretation does not apply to financial instruments that will or may be settled in the entity's own equity instruments.~~

Issue

- 3 4-Many financial instruments, including members' shares, have characteristics of equity instruments, including voting rights and rights to participate in dividend or similar distributions. Some financial instruments give the holder the right to request redemption for cash or another financial asset, but may include or be subject to limits on whether the financial instruments will be redeemed. The following paragraphs outline ~~How should~~ those redemption terms should be evaluated in determining whether the financial instruments should be classified as liabilities or net assets/equity.²

Consensus

Application of IPSASs to Members' Shares in Co-Operative Entities and Similar Instruments

- 4 ~~5~~-The contractual right of the holder of a financial instrument (including members' shares in co-operative entities) to request redemption does not, in itself, require that financial instrument to be classified as a financial liability. Rather, the entity must consider all of the terms and conditions of the financial instrument in determining its classification as a financial liability or an equity instrument. Those terms and conditions include relevant local laws, regulations and the entity's governing charter in effect at the date of classification, but not expected future amendments to those laws, regulations or charter.
- 5 ~~6~~-Members' shares that would be classified as equity instruments if the members did not have a right to request redemption are equity instruments if either of the conditions described in paragraphs ~~67~~ and ~~78~~ is present or the members' shares have all the features and meet the conditions in paragraphs 15 and 16 or paragraphs 17 and 18 of ~~IPSAS XX(15) ED 37 IAS 32~~. Demand deposits, including current accounts, deposit accounts and similar contracts that arise when members act as customers are financial liabilities of the entity.
- 6 ~~7~~-Members' shares are equity instruments if the entity has an unconditional right to refuse redemption of the members' shares.
- 7 ~~8~~-Local law, regulation or the entity's governing charter can impose various types of prohibitions on the redemption of members' shares, e.g. unconditional prohibitions or prohibitions based on liquidity criteria. If redemption is unconditionally prohibited by local law, regulation or the entity's governing charter, members' shares are equity instruments. However, provisions in local law, regulation or the entity's governing charter that prohibit redemption only if conditions—such as liquidity constraints—are met (or are not met) do not result in members' shares being equity instruments.
- 8 ~~9~~-An unconditional prohibition may be absolute, in that all redemptions are prohibited. An unconditional prohibition may be partial, in that it prohibits redemption of members' shares if redemption would cause the number of members'

shares or amount of paid-in capital from members' shares to fall below a specified level. Members' shares in excess of the prohibition against redemption are liabilities, unless the entity has the unconditional right to refuse redemption as described in paragraph 6 or the members' shares have all the features and meet the conditions in paragraphs 15 and 16 or paragraphs 17 and 18 of ~~ED 37 IAS 32~~~~IPSAS XX(15)~~. In some cases, the number of shares or the amount of paid-in capital subject to a redemption prohibition may change from time to time. Such a change in the redemption prohibition leads to a transfer between financial liabilities and net assets/equity.

- 9 ~~40~~-At initial recognition, the entity shall measure its financial liability for redemption at fair value. In the case of members' shares with a redemption feature, the entity measures the fair value of the financial liability for redemption at no less than the maximum amount payable under the redemption provisions of its governing charter or applicable law discounted from the first date that the amount could be required to be paid (see example 3).
- 10 ~~44~~-As required by paragraph 40 of ~~ED 37 IPSAS XX(15)~~~~IAS 32~~, distributions to holders of equity instruments are recognised directly in net assets/equity, net of any income tax benefits (where applicable). Interest, dividends or similar distributions and other returns relating to financial instruments classified as financial liabilities are expenses, regardless of whether those amounts paid are legally characterised as dividends or similar distributions, interest or otherwise.
- 11 ~~43~~-When a change in the redemption prohibition leads to a transfer between financial liabilities and net assets/equity, the entity shall disclose separately the amount, timing and reason for the transfer.
- 11 ~~42~~-The following Appendix, which is an integral part of the consensus, provides examples illustrate the of the application of the preceding paragraphs ~~this consensus~~.

Illustrative Examples

~~This appendix sets out seven examples of the application of the IFRIC consensus. The examples do not constitute an exhaustive list; other fact patterns are possible. Each example assumes that there are no conditions other than those set out in the facts of the example that would require the financial instrument to be classified as a financial liability and that the financial instrument does not have all of the features or does not meet the conditions in paragraph 15 and 16 or paragraphs 17 and 18 of ~~ED 37 IPSAS XX(15)~~ ~~IAS 32~~.~~

Unconditional right to refuse redemption (paragraph 6)

Example 1

Facts

- 12 ~~A2~~-The entity's charter states that redemptions are made at the sole discretion of the entity. The charter does not provide further elaboration or limitation on that discretion. In its history, the entity has never refused to redeem members' shares, although the governing board has the right to do so.

Classification

- 13 ~~A3~~-The entity has the unconditional right to refuse redemption and the members' shares are classified as equity instruments. ~~ED 37 IPSAS XX(15)~~ ~~IAS 32~~ establishes principles for classification that are based on the terms of the financial instrument and notes that a history of, or intention to make, discretionary payments does not trigger liability classification. Paragraph AG48 of ~~ED 37 IPSAS XX(15)~~ ~~IAS 32~~ states:

When preference shares are non-redeemable, the appropriate classification is determined by the other rights that 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 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:

- (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 on the ordinary shares if dividends 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 ~~profit or loss~~ for a period; or
- (f) An ability or inability of the issuer to influence the amount of its surplus or deficit ~~profit or loss~~ for the period.

Example 2

Facts

- 14 ~~A4~~–The entity’s charter states that redemptions are made at the sole discretion of the entity. However, the charter further states that approval of a redemption request is automatic unless the entity is unable to make payments without violating local regulations regarding liquidity or reserves.

Classification

- 15 ~~A5~~–The entity does not have the unconditional right to refuse redemption and the members’ shares are classified as a financial liability. The restrictions described above are based on the entity’s ability to settle its liability. They restrict redemptions only if the liquidity or reserve requirements are not met and then only until such time as they are met. Hence, they do not, under the principles established in ~~ED 37 IPSAS XX(15) IAS 32~~, result in the classification of the financial instrument as equity instruments. Paragraph AG47 of ~~ED 37 IPSAS XX(15) IAS 32~~ states:

Preference shares may be issued with various rights. In determining whether a preference share is a financial liability or an equity instrument, an issuer assesses the particular rights attaching to the share to determine whether it exhibits the fundamental characteristic of a financial liability. For example, a preference share that provides for redemption on a specific date or at the option of the holder contains a financial liability because 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 preference share when contractually required to do so, whether because of a lack of funds, a statutory restriction or insufficient surpluses–~~profits~~ or reserves, does not negate the obligation.* [Emphasis added]

Prohibitions against redemption (paragraphs 7 and 8)

Example 3

Facts

- 16 ~~A6~~–A co-operative entity has issued shares to its members at different dates and for different amounts in the past as follows:

- (a) ~~4~~–January 20X1, 1 100,000 shares at CU10 each (CU1,000,000);
- (b) ~~4~~–January, 1 20X2 100,000 shares at CU20 each (a further CU2,000,000, so that the total for shares issued is CU3,000,000).

—Shares are redeemable on demand at the amount for which they were issued.

- 17 ~~A7~~–The entity’s charter states that cumulative redemptions cannot exceed 20 per cent of the highest number of its members’ shares ever outstanding. At ~~31~~–December, 31 20X2 the entity has 200,000 of outstanding shares, which is the highest number of members’ shares ever outstanding and no shares have been redeemed in the past. On ~~4~~–January, 1 20X3 the entity amends its governing charter and increases the permitted level of cumulative redemptions to 25 per cent of the highest number of its members’ shares ever outstanding.

Classification

Before the governing charter is amended

- 18 ~~A8~~–Members’ shares in excess of the prohibition against redemption are financial liabilities. The co-operative entity measures this financial liability at fair value at initial recognition. Because these shares are redeemable on demand, the co-operative entity determines the fair value of such financial liabilities as required by paragraph 49 of ~~ED 37 IPSAS XX IAS 39~~, which states: ‘The fair value of a financial liability with a demand feature (e.g. a demand deposit) is not less than the amount payable on demand ...’ Accordingly, the co-operative entity classifies as financial liabilities the maximum amount payable on demand under the redemption provisions.

- 19 ~~A9~~–On ~~4~~–January, 1 20X1 the maximum amount payable under the redemption provisions is 20,000 shares at CU10 each and accordingly the entity classifies CU200,000 as ~~a~~–financial liability and CU800,000 as equity instruments. However, on ~~4~~–January, 1 20X2 because of the new issue of shares at CU20, the maximum amount payable under the redemption provisions increases to 40,000 shares at CU20 each. The issue of additional shares at CU20 creates a new liability that is measured on initial recognition at fair value. The liability after these shares have been issued is 20 per cent of the total shares in issue (200,000), measured at CU20, or CU800,000. This requires recognition of an additional liability of CU600,000. In this example no gain or loss is recognized. Accordingly the entity now classifies CU800,000 as ~~a~~–financial liabilities and CU2,200,000 as equity instruments. This example assumes these amounts are not changed between ~~4~~–January, 1 20X1 and ~~31~~–December, 31 20X2.

After the governing charter is amended

- 20 ~~A10~~ Following the change in its governing charter the co-operative entity can now be required to redeem a maximum of 25 per cent of its outstanding shares or a maximum of 50,000 shares at CU20 each. Accordingly, on 1-January, 1 20X3 the co-operative entity classifies as financial liabilities an amount of CU1,000,000 being the maximum amount payable on demand under the redemption provisions, as determined in accordance with paragraph 49 of ~~ED 389 IPSAS XX~~ IAS 39. It therefore transfers on 1-January, 1 20X3 from net assets/equity to financial liabilities an amount of CU200,000, leaving CU2,000,000 classified as equity instruments. In this example the entity does not recognize a gain or loss on the transfer.

Example 4

Facts

- 21 ~~A11~~ Local law governing the operations of co-operatives, or the terms of the entity's governing charter, prohibit an entity from redeeming members' shares if, by redeeming them, it would reduce paid-in capital from members' shares below 75 per cent of the highest amount of paid-in capital from members' shares. The highest amount for a particular co-operative is CU1,000,000. At the end of the reporting period the balance of paid-in capital is CU900,000.

Classification

- 22 ~~A12~~ In this case, CU750,000 would be classified as equity instruments and CU150,000 would be classified ~~as~~ as financial liabilities. In addition to the paragraphs already cited, paragraph 22(~~be~~) of ~~ED 37 IPSAS XX(15)~~ IAS 32 states in part:

... 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, except for those instruments classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18. The financial instrument is a financial liability 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. 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, except for those instruments classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18.

- 23 ~~A13~~ The redemption prohibition described in this example is different from the restrictions described in paragraphs 234 and AG47 of ~~ED 37 IPSAS XX(15)~~ IAS 32. Those restrictions are limitations on the ability of the entity to pay the amount due on a financial liability, i.e. they prevent payment of the liability only if specified conditions are met. In contrast, this example describes an unconditional prohibition on redemptions beyond a specified amount, regardless of the entity's ability to redeem members' shares (e.g. given its cash resources, surpluses ~~profits~~ or distributable reserves). In effect, the prohibition against redemption prevents the entity from incurring any financial liability to redeem more than a specified amount of paid-in capital. Therefore, the portion of shares subject to the redemption prohibition is not a financial liability. While each member's shares may be redeemable individually, a portion of the total shares outstanding is not redeemable in any circumstances other than liquidation of the entity.

Example 5

Facts

- 24 ~~A14~~ The facts of this example are as stated in example 4. In addition, at the end of the reporting period, liquidity requirements imposed in the local jurisdiction prevent the entity from redeeming any members' shares unless its holdings of cash and short-term investments are greater than a specified amount. The effect of these liquidity requirements at the end of the reporting period is that the entity cannot pay more than CU50,000 to redeem the members' shares.

Classification

- 25 ~~A15~~ As in example 4, the entity classifies CU750,000 as equity instruments and CU150,000 as a financial liability. This is because the amount classified as a liability is based on the entity's unconditional right to refuse redemption and not on conditional restrictions that prevent redemption only if liquidity or other conditions are not met and then only until such time as they are met. The provisions of paragraphs 234 and AG47 of ~~ED 37 IPSAS XX(15)~~ IAS 32 apply in this case.

Example 6

Facts

- 26 ~~A16~~ The entity's governing charter prohibits it from redeeming members' shares, except to the extent of proceeds received from the issue of additional members' shares to new or existing members during the preceding three years.

Proceeds from issuing members' shares must be applied to redeem shares for which members have requested redemption. During the three preceding years, the proceeds from issuing members' shares have been CU12,000 and no member's shares have been redeemed.

Classification

- 27 ~~A17~~ The entity classifies CU12,000 of the members' shares as financial liabilities. Consistently with the conclusions described in example 4, members' shares subject to an unconditional prohibition against redemption are not financial liabilities. Such an unconditional prohibition applies to an amount equal to the proceeds of shares issued before the preceding three years, and accordingly, this amount is classified as equity instruments. However, an amount equal to the proceeds from any shares issued in the preceding three years is not subject to an unconditional prohibition on redemption. Accordingly, proceeds from the issue of members' shares in the preceding three years give rise to financial liabilities until they are no longer available for redemption of members' shares. As a result the entity has a financial liability equal to the proceeds of shares issued during the three preceding years, net of any redemptions during that period.

Example 7

Facts

- 28 ~~A18~~ The entity is a co-operative bank. Local law governing the operations of co-operative banks state that at least 50 per cent of the entity's total 'outstanding liabilities' (a term defined in the regulations to include members' share accounts) has to be in the form of members' paid-in capital. The effect of the regulation is that if all of a co-operative's outstanding liabilities are in the form of members' shares, it is able to redeem them all. On ~~31~~ December, 31 20X1 the entity has total outstanding liabilities of CU200,000, of which CU125,000 represent members' share accounts. The terms of the members' share accounts permit the holder to redeem them on demand and there are no limitations on redemption in the entity's charter.

Classification

- 29 ~~A19~~ In this example members' shares are classified as financial liabilities. The redemption prohibition is similar to the restrictions described in paragraphs 234 and AG47 of ED 37-IPSAS XX (15) ~~IAS 32~~. The restriction is a conditional limitation on the ability of the entity to pay the amount due on a financial liability, i.e. they prevent payment of the liability only if specified conditions are met. More specifically, the entity could be required to redeem the entire amount of members' shares (CU125,000) if it repaid all of its other liabilities (CU75,000). Consequently, the prohibition against redemption does not prevent the entity from incurring a financial liability to redeem more than a specified number of members' shares or amount of paid-in capital. It allows the entity only to defer redemption until a condition is met, i.e. the repayment of other liabilities. Members' shares in this example are not subject to an unconditional prohibition against redemption and are therefore classified as financial liabilities.

Amendments to other IPSASs

The amendments in this appendix shall be applied for annual financial statements covering periods beginning on or after Month, Day, Year. If an entity applies this Standard for an earlier period, these amendments shall be applied for that earlier period.

- A1 In IPSAS 23, “Revenue from Non-Exchange Transactions (Taxes and Transfers)”, paragraph 37 is amended as follows:

Contributions from Owners

37. Contributions from owners are defined in IPSAS 1. For a transaction to qualify as a contribution from owners, it will be necessary to satisfy the characteristics identified in that definition. In determining whether a transaction satisfies the definition of a contribution from owners, the substance rather than the form of the transaction is considered. Paragraph 38 indicates the form that contributions from owners may take. If, despite the form of the transaction, the substance is clearly that of a loan or another kind of liability, or revenue, the entity recognizes it as such and makes an appropriate disclosure in the notes to the general purpose financial statements, if material. For example, if a transaction purports to be a contribution from owners, but specifies that the reporting entity will pay fixed distributions to the transferor, with a return of the transferor’s investment at a specified future time, the transaction is more characteristic of a loan. For contractual arrangements, an entity also considers the guidance in ~~IPSAS 15~~ ED 37, “Financial Instruments: Presentation” when distinguishing liabilities from contributions from owners.

- A2 In IPSAS 1, “Presentation of Financial Statements” (as revised in 2006), the following paragraphs are inserted:

Definitions

- 7A The following terms are described in ~~ED 37IPSAS XX(15)~~, “Financial Instruments: Presentation” and are used in this Standard with the meaning specified in ~~ED 37IPSAS XX(15)~~:
- ~~(e)(a)~~ (a) Puttable financial instrument classified as an equity instrument (described in paragraphs 15 and 16 of ~~ED 37IPSAS XX(15)~~);
- ~~(d)(b)~~ (b) An instrument that imposes on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and is classified as an equity instrument (described in paragraphs 17 and 18 of ~~ED 37IPSAS XX(15)~~).

Information to be Presented either on the Face of the Statement of Financial Position or in the Notes

95A If an entity has reclassified

- ~~(a)~~ ~~(a)~~ (a) puttable financial instrument classified as an equity instrument, or
- ~~(b)~~ ~~(b)~~ (b) an instrument that imposes on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and is classified as an equity instrument
- between financial liabilities and net assets/equity, it shall disclose the amount reclassified into and out of each category (financial liabilities or net assets/equity), and the timing and reason for that reclassification.

Puttable financial instruments classified as net assets/equity [to be included under the section dealing with “capital” which is added as a result of ~~ED 39IFRS 7~~]

- XX For puttable financial instruments classified as equity instruments, an entity shall disclose (to the extent not disclosed elsewhere):

- ~~(i)(a)~~ (i)(a) summary quantitative data about the amount classified as net assets/equity;
- ~~(ii)(b)~~ (ii)(b) its objectives, policies and processes for managing its obligation to repurchase or redeem the instruments when required to do so by the instrument holders, including any changes from the previous period;
- ~~(iii)(c)~~ (iii)(c) the expected cash outflow on redemption or repurchase of that class of financial instruments; and
- ~~(iv)(d)~~ (iv)(d) information about how the expected cash outflow on redemption or repurchase was determined.

A3 In IPSAS 1, paragraph 150 is amended as follows:

Other Disclosures

150 An entity shall disclose the following, if not disclosed elsewhere in information published with the financial statements:

...

- (e) the name of the controlling entity and the controlling entity of the economic entity; and**
- (f) if it is a limited life entity, information regarding the length of its life.**

Illustrative Examples

These examples accompany, but are not part of, [ED 37 IPSAS-15](#).

Accounting for contracts on equity instruments of an entity

IE1 The following examples illustrate the application of paragraphs [13-32](#) ~~45-27~~ and IAS 39 to the accounting for contracts on an entity's own equity instruments. In these examples, monetary amounts are denominated in 'currency units' (CU).

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 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:

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

(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 ~~1~~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 ~~31~~January, 31 20X3 in exchange for a payment of CU104,000 in cash (i.e. CU104 per share) on ~~31~~ January, 31 20X3. The contract will be settled net in cash. Entity A records the following journal entries.

~~1~~February, 1 20X2

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

~~31~~December, 31 20X2

On ~~31~~December, 31 20X2, 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.

Dr Forward asset	CU6,300	
Cr Gain		CU6,300

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

31 January, 31 20X3

On ~~31~~ January, 31 20X3, the market price per share has decreased to CU106. The fair value of the forward contract is CU2,000 [(CU106 × 1,000) – CU104,000].

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 (CU106 × 1,000) to Entity A, so Entity B pays the net amount of CU2,000 to Entity A.

Dr Loss	CU4,300	
Cr Forward asset		CU4,300

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:

31 January, 31 20X3

The contract is settled net in shares. Entity A has an obligation to deliver CU104,000 (CU104 × 1,000) worth of its shares to Entity B and Entity B has an obligation to deliver CU106,000 (CU106 × 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 <u>Net assets/equity</u>	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 × 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.

1 February, 1 20X2

Dr <u>Net assets/equity</u>	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 (see IAS 39, paragraph AG64).

~~31~~December, 31 20X2

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.

~~31~~January, 31 20X3

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 recognises 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 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:

Contract date	4 February, <u>1</u> 20X2
Maturity date	31 January, <u>31</u> 20X3

Market price per share on 4 February, <u>1</u> 20X2	CU100
Market price per share on 31 December, <u>31</u> 20X2	CU110
Market price per share on 31 January, <u>31</u> 20X3	CU106
Fixed forward price to be paid on 31 January, <u>31</u> 20X3	CU104
Present value of forward price on 4 February, <u>1</u> 20X2	CU100
Number of shares under forward contract	1,000
Fair value of forward on 4 February, <u>1</u> 20X2	CU0
Fair value of forward on 31 December, <u>31</u> 20X2	(CU6,300)

Fair value of forward on ~~31~~January, 31 20X3 (CU2,000)

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

IE8 On ~~1~~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 ~~31~~January, 31 20X3 in exchange for CU104,000 in cash (i.e. CU104 per share) on ~~31~~January, 31 20X3. The contract will be settled net in cash. Entity A records the following journal entries.

1 February, 1 20X2

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

31-December, 31 20X2

Dr Loss	CU6,300	
	Cr Forward liability	CU6,300

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

31-January, 31 20X3

Dr Forward liability	CU4,300	
	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:

31-January, 31 20X3

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 Forward liability	CU2,000	
	Cr <u>Net assets/equity</u>	CU2,000

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

~~1~~February, 1 20X2

No entry is made on ~~1~~ February, 1. 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.

~~31~~December, 31 20X2

No entry is made on ~~31~~ December, 31 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.

~~31~~January, 31 20X3

On ~~31~~ January, 31 20X3, Entity A receives CU104,000 in cash and delivers 1,000 shares.

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

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 recognises 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:

Contract date	1 February, <u>1</u> 20X2
Exercise date	31 January, <u>31</u> 20X3
	(European terms, i.e. it can be exercised only at maturity)
Exercise right holder	Reporting entity (Entity A)

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

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

IE13 On ~~4~~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 ~~31~~ January, 31 20X3 in exchange for CU102,000 in cash (i.e. CU102 per share) on ~~31~~ January, 31 20X3, 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.

~~1~~ February, 1 20X2

The price per share when the contract is agreed on ~~4~~February, 1 20X2 is CU100. The initial fair value of the option contract on ~~4~~ 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.

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

To recognise the purchased call option.

~~31~~ December, 31 20X2

On ~~31~~ December, 31 20X2, 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.

~~31~~ January, 31 20X3

On ~~31~~ January, 31 20X3, 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:

~~31~~ January, 31 20X3

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 <u>Net assets/equity</u>	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.

4 February, 1 20X2

Dr <u>Net assets/equity</u>	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 recognised in net assets/equity.

31 December, 31 20X2

No entry is made on ~~31~~ December, 31 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.

31 January, 31 20X3

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 <u>Net assets/equity</u>	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 recognises 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	4 February, 1 20X2
Exercise date	31 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 1 February, <u>1</u> 20X2	CU100
Market price per share on 31 December, <u>31</u> 20X2	CU104
Market price per share on 31 January, <u>31</u> 20X3	CU104
Fixed exercise price to be paid on 31 January, <u>31</u> 20X3	CU102
Number of shares under option contract	1,000
Fair value of option on 1 February, <u>1</u> 20X2	CU5,000
Fair value of option on 31 December, <u>31</u> 20X2	CU3,000
Fair value of option on 31 January, <u>31</u> 20X3	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 ~~1~~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 ~~31~~January, 31 20X3 in exchange for CU102,000 in cash (i.e. CU102 per share) on ~~31~~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.

~~1~~ February, 1 20X2

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

To recognise the written call option.

~~31~~December, 31 20X2

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

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

~~31~~ January, 31 20X3

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:

31-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 ($\text{CU104} \times 1,000$) worth of Entity A's shares to Entity B in exchange for CU102,000 ($\text{CU102} \times 1,000$) 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 ($\text{CU2,000}/\text{CU104}$).

Dr Call option obligation	CU2,000	
Cr <u>Net assets/equity</u>		CU2,000

To record the settlement of the option contract. The settlement is accounted for as a transaction in net assets/equity ~~an equity 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 ($\text{CU102} \times 1,000$) in cash, if Entity B exercises its option. Entity A records the following journal entries.

1-February, 1 20X2

Dr Cash	CU5,000	
Cr <u>Net assets/equity</u>		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 recognised in net assets/equity. Upon exercise, the call would result in the issue of a fixed number of shares in exchange for a fixed amount of cash.

31-December, 31 20X2

No entry is made on 31 December 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.

31-January, 31 20X3

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 <u>Net assets/equity</u>		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 recognises 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	4 February, <u>1</u> 20X2
Exercise date	31 January, <u>31</u> 20X3
	(European terms, i.e. it can be exercised only at maturity)
Exercise right holder	Reporting entity (Entity A)

Market price per share on 4 February, <u>1</u> 20X2	CU100
Market price per share on 31 December, <u>31</u> 20X2	CU95
Market price per share on 31 January, <u>31</u> 20X3	CU95
Fixed exercise price to be paid on 31 January, <u>31</u> 20X3	CU98
Number of shares under option contract	1,000
Fair value of option on 4 February, <u>1</u> 20X2	CU5,000
Fair value of option on 31 December, <u>31</u> 20X2	CU4,000
Fair value of option on 31 January, <u>31</u> 20X3	CU3,000

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

IE23 On ~~4~~ 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 ~~31~~ January, 31 20X3 at a strike price of CU98,000 (i.e. CU98 per share) on ~~31~~ January, 31 20X3, 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.

4 February, 1 20X2

The price per share when the contract is agreed on ~~4~~ February, 1 20X2 is CU100. The initial fair value of the option contract on ~~4~~ 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 recognise the purchased put option.

31 December, 31 20X2

On 31 December 20X2 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 $[(CU98 - CU95) \times 1,000]$ and CU1,000 is the remaining time value.

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

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

31 January, 31 20X3

On 31 January, 31 20X3 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 $[(CU98 - CU95) \times 1,000]$ because no time value remains.

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

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 $(CU95 \times 1,000)$ to Entity B, so Entity B pays the net amount of CU3,000 to Entity A.

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

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:

31 January, 31 20X3

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 $(CU3,000/CU95)$.

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

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.

1 February, 1 20X2

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

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 recognised directly in net assets/equity. Upon exercise, it results in the issue of a fixed number of shares in exchange for a fixed price.

~~31~~ December, 31 20X2

No entry is made on ~~31~~ December, 31 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.

~~31~~ January, 31 20X3

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.

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

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 recognises 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, <u>1</u> 20X2
Exercise date	31 January, <u>31</u> 20X3
	(European terms, i.e. it can be exercised only at maturity)
Exercise right holder	Counterparty (Entity B)
Market price per share on + February, <u>1</u> 20X2	CU100
Market price per share on 31 December, <u>31</u> 20X2	CU95
Market price per share on 31 January, <u>31</u> 20X3	CU95
Fixed exercise price to be paid on 31 January, <u>31</u> 20X3	CU98
Present value of exercise price on + February, <u>1</u> 20X2	CU95
Number of shares under option contract	1,000
Fair value of option on + February, <u>1</u> 20X2	CU5,000
Fair value of option on 31 December, <u>31</u> 20X2	CU4,000
Fair value of option on 31 January, <u>31</u> 20X3	CU3,000

(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 4 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 ~~31~~ January, 31 20X3 in exchange for CU98,000 in cash (i.e. CU98 per share) on ~~31~~ 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.

~~4~~February, 1 20X2

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

To recognise the written put option.

~~31~~December, 31 20X2

Dr Put option liability	CU1,000	
Cr Gain		CU1,000

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

~~31~~January, 31 20X3

Dr Put option liability	CU1,000	
Cr Gain		CU1,000

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 (CU95 × 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:

~~31~~January, 31 20X3

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 (CU95 × 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 <u>Net assets/equity</u>		CU3,000

To record the settlement of the option contract. The issue of Entity A's own shares is accounted for as a transaction in net assets/equity ~~an equity 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 (CU98 × 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.

1 February, 1 20X2

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

To recognise the option premium received of CU5,000 in net assets/equity.

Dr <u>Net assets/equity</u>	CU95,000	
	Cr Liability	CU95,000

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

31 December, 31 20X2

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.

31 January, 31 20X3

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 × 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 recognises 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 IAS 32

Example 7: Entities with no net assets/equity

IE32 The following example illustrates a format of a statement of financial performance comprehensive income and statement of financial position that may be used by entities such as mutual funds that do not have net assets/equity as defined in IAS 32. Other formats are possible.

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

	<u>20X1</u>		<u>20X0</u>
	<u>CU</u>		<u>CU</u>
Revenue	<u>2,956</u>	-	<u>1,718</u>
Total Revenue	<u>2,956</u>	-	<u>1,718</u>
Expenses (classified by nature or function)	- (644)	-	(614)
Finance costs			
– other finance costs	(47)		(47)
– distributions to unitholders	(50)		(50)
Total Expenses	<u>(741)</u>		<u>(711)</u>
	<u>(644)</u>		<u>(614)</u>
Profit from operating activities	<u>2,312</u>		<u>1,104</u>
Finance costs			
– other finance costs	(47)		(47)
– distributions to unitholders	(50)		(50)
Surplus for the year	<u>2,215</u>		<u>1,007</u>
Change in net assets attributable to unitholders	- <u>2,215</u>	-	<u>1,007</u>

Statement of financial position at 31-December, 31 20X1

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

<u>unitholders (classified in accordance with IPSAS 1 IAS 1)</u>							
-	-	-	(280)	-	-	-	(136)
<u>Net assets attributable to unitholders</u>	-	-	<u>91,869</u>	-	-	-	<u>80,051</u>

Example 8: Entities with some net assets/equity

IE33 The following example illustrates a format of a statement of financial performance ~~comprehensive income~~ and statement of financial position that may be used by entities whose share capital is not net assets/equity as defined in IAS 32 because the entity has an obligation to repay the share capital on demand. Other formats are possible.

Statement of comprehensive income financial performance for the year ended 31 December, 31 20X1			
	20X1		20X0
	<u>CU</u>		<u>CU</u>
Revenue	<u>472</u>		<u>498</u>
Total Revenue	<u>472</u>		<u>498</u>
Expenses (classified by nature or function)	(367)		(396)
<u>Finance costs</u>			
– other finance costs	(4)		(4)
– distributions to members	(50)		(50)
Total Expenses	<u>(421)</u>		<u>(450)</u>
<u>Profit from operating activities</u>	<u>105</u>		<u>102</u>
<u>Finance costs</u>			
– other finance costs	(4)		(4)
– distributions to members	(50)		(50)
Surplus for the year	<u>51</u>		<u>48</u>
Change in net assets attributable to members	- 51	-	48

Statement of financial position at 31-December, 31 20X1

	20X1		20X0
	<u>CU</u>		<u>CU</u>
ASSETS			
Non-current assets (classified in accordance with IPSAS 1 IAS 1)	<u>908</u>	-	<u>830</u>
Total non-current assets	- 908	-	830
Current assets (classified in accordance with IPSAS 1 IAS 1)	<u>383</u>	-	<u>350</u>

<u>Total current assets</u>	-	-	<u>383</u>	-	-	-	<u>350</u>
<u>Total assets</u>	-	-	<u>1,291</u>	-	-	-	<u>1,180</u>
 <u>LIABILITIES</u>							
<u>Current liabilities (classified in accordance with IPSAS 1 IAS 4)</u>	372	-	-	-	338	-	-
<u>Share capital repayable on demand</u>	<u>202</u>	-	-	-	<u>161</u>	-	-
<u>Total current liabilities</u>	-	-	(574)	-	-	-	(499)
<u>Total assets less current liabilities</u>	-	-	<u>717</u>	-	-	-	<u>681</u>
 <u>Non-current liabilities (classified in accordance with IPSAS 1 IAS 4)</u>	187	-	-	-	196	-	-
-	-	-	(187)	-	-	-	(196)
 <u>OTHER COMPONENTS OF EQUITY^(a)</u>	-	-	-	-	-	-	-
<u>Reserves e.g. revaluation surplus, accumulated surplus retained earnings etc</u>	<u>530</u>	-	-	-	<u>485</u>	-	-
-	-	-	<u>530</u>	-	-	-	<u>485</u>
-	-	-	<u>717</u>	-	-	-	<u>681</u>
 <u>MEMORANDUM NOTE – Total members' interests</u>							
<u>Share capital repayable on demand</u>	-	-	<u>202</u>	-	-	-	<u>161</u>
<u>Reserves</u>	-	-	<u>530</u>	-	-	-	<u>485</u>
-	-	-	<u>732</u>	-	-	-	<u>646</u>

(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 97: Separation of a compound financial instrument on initial recognition

IE342 Paragraph 335 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.

IE353 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.

IE364 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 component of net assets/equity 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.

CU

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

Example 108: Separation of a compound financial instrument with multiple embedded derivative features

IE375 The following example illustrates the application of paragraph 36 to the separation of the liability and equity components of a compound financial instrument with multiple embedded derivative features into the liability component and the component of net assets/equity.

IE386 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 equity 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 an equity conversion option is CU2. In this case, the value allocated to the liability component under paragraph 36 is CU55 (CU57 – CU2) and the value allocated to the component of net assets/equity component is CU5 (CU60 – CU55).

Example 9: Repurchase of a convertible instrument

IE397 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 the liability component and the component of net assets/equity 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.

IE4038 On 1 January, 1 20X0, Entity A issued a 10 per cent convertible debenture with a face value of CU1,000 maturing on 31 December, 31 20X9. 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.

IE4139 In the financial statements of Entity A the carrying amount of the debenture was allocated on issue as follows:

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

IE420 On 1 January, 1 20X5, the convertible debenture has a fair value of CU1,700.

IE434 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.

IE442 The repurchase price is allocated as follows:

	Carrying value	Fair value	Difference
Liability component:	CU	CU	CU

Present value of 10 remaining half-yearly interest payments of CU50, discounted at 11% and 8%, respectively	377	405	
Present value of CU1,000 due in 5 years, discounted at 11% and 8%, compounded half-yearly, respectively	585	676	
	<u>962</u>	<u>1,081</u>	<u>(119)</u>
<u>Component of net assets/equity component</u>	60	619 ^(a)	(559)
Total	<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.

IE453 Entity A recognises the repurchase of the debenture as follows:

Dr Liability component	CU962	
Dr Debt settlement expense (profit or loss <u>surplus or deficit</u>)	CU119	
Cr Cash		CU1,081

To recognise the repurchase of the liability component.

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

To recognise the cash paid for the component of net assets/equity component.

IE464 The component of net assets/equity component remains as net assets/equity, but may be transferred from one line item within net assets/equity to another.

Example 110: Amendment of the terms of a convertible instrument to induce early conversion

IE475 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.

IE486 On 1 January, 1 20X0, Entity A issued a 10 per cent convertible debenture with a face value of CU1,000 with the same terms as described in Example 9. On 1 January, 1 20X1, 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, 1 20X1 (i.e. within 60 days).

IE497 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:*

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

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

Face amount	CU1,000
Original conversion price	<u>/CU25</u> per share
Number of ordinary shares to be issued on conversion	40 Shares
<i>Number of incremental ordinary shares issued upon conversion</i>	10 Shares

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

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

IE48 The incremental consideration of CU400 is recognised as a loss in surplus or deficit ~~profit or loss~~.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, ED 37.

Introduction

- BC1. This Basis for Conclusions summarizes the International Public Sector Accounting Standards Board's (IPSASB) considerations in reaching the conclusions in ED 37, "Financial Instruments: Presentation". As this IPSAS is based on IAS 32, "Financial Instruments: Presentation" issued by the International Accounting Standards Board (IASB), the Basis for Conclusions outlines only those areas where the ED 37 deviates from the main requirements of IAS 32.
- BC2. This project on financial instruments is ~~noted as~~ a key part of the IPSASB's convergence program which aims to converge IPSASs with International Financial Reporting Standards (IFRSs). The IPSASB acknowledges that there are other aspects of financial instruments, in so far as they relate to the public sector, which are not addressed in IAS 32. These may be addressed by future projects of the IPSASB. In particular, the IPSASB acknowledges that future projects may be required to address:
- Certain transactions undertaken by central banks; and
 - Receivables and payables that arise from arrangements that are, in substance, similar to, and have the same economic effect as, financial instruments, but are not contractual in nature.
- BC3. In developing this IPSAS, the IPSASB agreed to retain the existing text of IAS 32 ~~as far as possible and making changes to ensure consistency with the terminology and presentational requirements of other IPSASs, wherever consistent with existing IPSASs~~, and deal with any public sector specific issues through additional ~~A~~application ~~G~~uidance.
- BC4. In September 2007 the IASB issued amendments to IAS 1, "Presentation of Financial Statements" which introduced a new concept into the presentation of financial statements called "comprehensive income". As the IPSASB has not yet considered this ~~component~~, along with some of the other amendments proposed in IAS 1, those ~~amendmentse~~y have not been included in ED 37.

Scope

Insurance and Financial Guarantee Contracts

- BC5. IAS 32 excludes all insurance contracts from the scope of IAS 32, except for financial guarantee contracts where the issuer elects to apply International Financial Reporting Standard 4 "Insurance Contracts" (IFRS 4) in recognizing and measuring such contracts. The scope of ED 37 also excludes all insurance contracts, except that:
- All financial guarantee contracts are to be treated as financial instruments in terms of ED 37, ED 38 and ED 39; and
 - Contracts that are ~~in substance~~ insurance contracts but involve the transfer financial risk may be treated as financial instruments in terms of ED 37, ED 38 and ED 39.

Defining Insurance Contracts

- BC6. IPSAS 15, issued in 2001, included a description of insurance contracts. Given that the IASB issued IFRS 4 after IPSAS 15, the existing description of an insurance contract has been replaced with the definition of an insurance contract from IFRS 4. The definition of an insurance contract has been included as part of the ~~A~~application ~~G~~uidance rather than as an additional definition in the main text of ED 37. The reason for this is that the Board has not yet considered insurance contracts in the public sector; therefore to include this as a defined term in the IPSASs would be premature.

Treating Financial Guarantees as Financial Instruments

- BC76. Under IAS 32, financial guarantee contracts should be treated as financial instruments, unless an issuer elects to apply IFRS 4 to those contracts. The IPSASB considered whether it should allow this option in ED 37. If the IPSASB allowed this alternative treatment, ED 37 would refer entities to either the international or national accounting standard dealing with insurance contracts because ~~there is no equivalent for IPSAS exists for~~ IFRS 4.
- BC78. Depending on ~~local circumstances in~~ each jurisdiction, this would mean that some entities ~~would~~ apply IFRS 4 while others ~~would~~ apply their own national practices in accounting for financial guarantee contracts. The application of different accounting principles for recognizing and measuring similar instruments would reduce the comparability of financial statements from one entity to another and one jurisdiction to another. So as to achieve

comparability of financial statements and, given the significance of financial guarantees in the public sector, the IPSASB believes it is appropriate to deal definitively with the accounting for financial guarantees by proposing a single accounting treatment.

Option to Treat Insurance Contracts that Transfer Financial Risk as Financial Instruments

- BC8. IPSAS 15 allowed entities to account for instruments that are, ~~in substance,~~ insurance contracts that result in the transfer of financial risk, as financial instruments. In the absence of an IPSAS on insurance contracts, the IPSASB concluded that it should allow entities to apply ED 37 to such contracts.

Identifying Contractual Financial Guarantees

- BC9. Financial instruments in ED 37 are defined as: “...any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity”. As arrangements in the public sector ~~arise through other means and not necessarily through contract~~ may arise through statutory powers ~~s,~~ the IPSASB developed additional application guidance to explain when financial guarantees are contractual or non-contractual. In considering this issue, the IPSASB concluded that financial guarantees should have the key features of a contractual arrangement. It also concluded that an entity should: ~~to be treated as a financial guarantee (see paragraphs BC12 to BC13), but also that an entity should distinguish the right to issue guarantees, which is often conferred on an entity through statutory or similar means, and the actual issuing of the guarantee in favour of a third party, irrespective of whether that party is explicitly or implicitly identified.~~

- BC10. ~~In assessing whether a financial guarantee is contractual, an entity assesses the terms of the arrangement between itself and the holder of the guarantee and ignores the fact that the guarantee may have originated through the exercise of statutory or similar means. For example, a government may guarantee the bond issue of one of its government business enterprises because legislation requires or permits it to do so. Essentially this arrangement provides the holder of those bonds with a financial guarantee. The issuer of the bond (in this case the government) assesses whether a contractual arrangement exists between itself and the bondholders and ignores the fact that the guarantee may have arisen through the exercise of its rights granted in legislation.~~

- BC11. ~~The additional application guidance also clarifies that the counterparties to financial guarantees where no specific counterparty is identified. In the public sector, financial guarantee contracts may be issued to a specific third party, i.e. the counterparty is identified explicitly, or they may be issued to the holder of an instrument, i.e. the counterparty is identified implicitly as the holders of the instruments. In assessing whether or not a financial guarantee contract is contractual or not, an entity considers both explicit and implicit counterparties to the arrangement.~~

Definitions

Contractual Arrangements

- BC102. Assets and liabilities in the public sector arise ~~out of~~ in a variety of ~~means~~ ways. Non-contractual arrangements do not give rise to financial instruments because the definition of a financial instrument refers to a ‘contract’. The IPSASB noted that, in certain jurisdictions, public sector entities are precluded from entering into formal contracts, but do enter into arrangements that have the substance of contracts. The IPSASB considered it appropriate to issue additional Application Guidance explaining ~~what~~ the factors an entity should consider in assessing whether an arrangement is contractual or non-contractual.

- BC13. The IPSASB considered that the following three elements should be present for an arrangement to be considered contractual and within the scope of ED 37:

~~— The parties to an arrangement enter into the transaction willingly. This would exclude transactions that arise through the exercise of statutory or similar rights which compel parties to transact with one another. For example, the levying of taxes by government on taxpayers give rise to a transaction in which either party is compelled to transact with one another because of certain provisions in legislation.~~

~~— The terms of the contract create rights and obligations for each party to the arrangement. Those rights and obligations need not result in equal performance by parties to the transaction i.e. if a transaction is non-exchange in nature, it is not automatically considered to be non-contractual. For example, under a contract of donation, the donor has an obligation to provide the resources stipulated in the agreement concluded with the recipient, while the recipient has the right to receive those resources. The fact that the performance under the contract is not equal because the recipient does not provide any consideration to the donor in return does not make the arrangement non-contractual.~~

~~The arrangement must be enforceable by law. The enforceability of contracts through legal means would depend on whether performance under the arrangement could be upheld in a court of law or through a similar process.~~

Contractual Non-Exchange Revenue Transactions

BC114. IPSAS 23, “Revenue from Non-Exchange Transactions (Taxes and Transfers)” prescribes the initial recognition, initial measurement and disclosure of assets and liabilities arising out of non-exchange revenue transactions. In acknowledging that certain non-exchange revenue transactions may be contractual in nature, there is an overlap between the requirements of ED 37 and IPSAS 23.

BC125. The IPSASB concluded that an entity should apply the requirements of IPSAS 23 in conjunction with ED 37. In particular, an entity considers the principles in ED 37 in considering whether an inflow of resources from a non-exchange revenue transaction results in a liability or a transaction that evidences a residual interest in the net assets of the entity.

Other

Interpretations issued-developed by the International Financial Reporting Interpretations Committee

BC136. ~~In developing ED 37, the IPSASB considered whether any Interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) are relevant to the presentation of financial instruments. In particular,~~ The IPSASB considered whether IFRIC 2, “Members’ Shares in Co-operative Entities and Similar Instruments” and IFRIC 11, “IFRS2 – Group and Treasury Share Transactions” were relevant for the types of instruments entered into by governments and entities in the public sector.

BC147. The IPSASB considered that IFRIC 11 is not relevant for the types of instruments entered into in the public sector as it deals with share-based payment transactions. While share-based payments may be common in Government Business Enterprises (GBE’s), they do not occur frequently within entities that are not GBE’s. As a result, the IPSASB has not included any principles from IFRIC 11 ~~into~~ ED 37.

BC158. IFRIC 2 provides guidance on the application of IAS 32 to members’ shares in co-operative entities and similar instruments. There is a strong link between IAS 32 and IFRIC 2 in relation to puttable financial instruments and obligations arising on liquidation. As the text of IAS 32 that deals with puttable financial instruments and obligations arising on liquidation has been retained in ED 37, IFRIC 2 would provide additional guidance to users of ED 37 in applying those principles to members’ interests in co-operative entities. The principles and examples from IFRIC 2 have been added to ED 37 as an authoritative appendix.

Comparison with IAS 32

~~Proposed~~ International Public Sector Accounting Standard ~~XX(1,xx (ED 37) 5)~~, “Financial Instruments: Presentation” is drawn primarily from International Accounting Standard 32, “Financial Instruments: Presentation” (issued originally in 2003, including amendments up to December 31 end 2008). At the time of issuing this Standard, the IPSASB has not yet considered the revision made by the IASB to IAS 1, “Presentation of Financial Statements” which introduces the concept of comprehensive income. As the IPSASB has not considered the concept of comprehensive income in the public sector, ED 37 IPSAS XX(15) does not reflect amendments made to IAS 32 as a consequence of the revisions made to IAS 1. The main differences between ED 37 IPSAS XX(15) and IAS 32 (2003) are as follows:-

- (a)• The scope of ED 37 IPSAS 15 is different from IAS 32. This Standard ~~prescribes that requires~~ financial guarantee contracts ~~are to be~~ treated as financial instruments and not as insurance contracts. In – while under IAS 32 entities are permitted to treat some financial guarantee contracts as insurance contracts.
- (b)• In certain instances, ED 37 IPSAS 15 uses different terminology from IAS 32. The most significant examples are the use of the terms “statement of financial position” “statement of financial performance” and “net assets/equity”. The equivalent terms in IAS 32 are “statement of comprehensive income or separate income statement (if presented) balance sheet” and “equity”.
- (c)• ED 37 IPSAS 15 does not distinguish between “revenue” and “income”. IAS 32 distinguishes between “revenue and “income”, with “income” having a broader meaning than the term “revenue”.
- (d)• Additional Application Guidance has been developed to explain the application of the principles in ~~the Standard~~ ED 37 to financial instruments ~~encountered held~~ in the public sector and to deal with certain public sector issues not addressed in IAS 32.
- (e)• Certain eExamples included in the text, Application Guidance and Illustrative Examples have either been amended or deleted based on their applicability to the public sector.
- (f)• Principles from IFRIC 2, “Members’ Shares in Co-operative Entities and Similar Other Instruments” have been included as an Appendix to this Standard,
- (g)• The transitional provisions in ~~this Standard are different in~~ ED 37 differ form those in IAS 32. This is because ~~they ED 37 provides~~ transitional guidance provisions for those entities applying this Standard for the first time or those applying accrual accounting for the first time.

~~Additional application guidance has been included in ED 37 to specifically deal with public sector issues not addressed by IAS 32.~~

~~Examples in the application guidance and illustrative examples have been amended to describe transactions and scenarios that are likely to occur in the public sector, as well as to accommodate concepts and terminology used in other IPSASs.~~

Exposure Draft 37

March 2009

Comments are requested by July 31 2009

*Proposed International Public Sector Accounting
Standard*

Financial Instruments: Presentation

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, “Financial Instruments: Presentation”, for publication in March 2009. The proposals in this Exposure Draft 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 July 30, 2009. All comments will be considered a matter of public record. Comments should be addressed to:

Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street, 4th Floor
Toronto, Ontario M5V 3H2 CANADA

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

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

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ACKNOWLEDGMENT

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OBJECTIVE

The objective of this Exposure Draft is to propose requirements for the classification of financial instruments, from the issuer's perspective, into financial assets, financial liabilities and equity, and for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities.

REQUEST FOR COMMENTS

The IPSASB invites comments on all the proposals in the Exposure Draft. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD

FINANCIAL INSTRUMENTS: PRESENTATION

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International Public Sector Accounting Standard XX, “Financial Instruments: Presentation” (IPSAS XX) is set out in paragraphs 1–62 All the paragraphs have equal authority except as noted otherwise. ED 37 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.

Introduction

IN1. International Public Sector Accounting Standard (IPSAS) XX, “Financial Instruments: Presentation”, replaces IPSAS 15, “Financial Instruments: Presentation and Disclosure” (issued December 2001), and should be applied for annual reporting periods beginning on or after Month Day, Year. Earlier application of this Standard, simultaneously with ED 38 and ED 39, is encouraged.

Reasons for Replacing IPSAS 15

IN2. The International Public Sector Accounting Standards Board replaced IPSAS 15 to converge public sector accounting standards with International Financial Reporting Standards (IFRSs) to the extent appropriate. In developing an IPSAS on the presentation of financial instruments, the IPSASB primarily used IAS 32, “Financial Instruments: Presentation” (issued in 2003) as amended as at December, 31 2008 and guidance in IFRIC 2, “Members Shares in Co-operative Entities and Similar Instruments”. Revisions made to IAS 32 up to December, 31 2008 have been considered, except those relating to amendments made to IAS 1, “Presentation of Financial Statements” in September 2007.

IN3. In developing this Standard, the IPSASB has departed from IAS 32 only where a public sector specific reason exists; such variances are noted in the Comparison with IAS 32.

Changes from Previous Requirements

IN4. The main changes from IPSAS 15 (2001) are described below.

General

IN5. This Standard does not prescribe disclosure requirements for financial instruments. The disclosure requirements relating to financial instruments are included in ED 39, “Financial Instruments: Disclosures”.

IN6. Application Guidance has been included as an appendix to ED37, which is an integral part of the Standard. Application Guidance explains selected issues pertaining to the principles included in the main text of ED 37. Guidance on the application of the principles in this Standard to members’ shares in co-operative entities and similar instruments has been provided in an appendix to the Standard. This Guidance is based on IFRIC 2 and is an integral part of the Standard.

IN7. Additional illustrative examples have also been included as an appendix to ED 37. However, these illustrative examples are not authoritative and accompany, rather than form part of, ED 37.

Scope

IN8. The scope has been amended as follows:

- Only those interests in controlled entities, joint ventures and associates that are measured in an entity’s separate financial statements using cost or the equity method are excluded from the scope of ED 37. Derivatives linked to interests in controlled entities, joint ventures and associates are however included in the scope of ED 37.
- Insurance contracts are excluded from the scope of ED 37, except:
 - Derivatives embedded in insurance contracts, if ED 38, “Financial Instruments: Recognition and Measurement” requires that they be accounted for separately.
 - Financial guarantee contracts issued by an entity.
 - Certain elements of insurance contracts that contain a discretionary participation feature, including any derivatives embedded in such contracts.

Entities are encouraged to apply this Standard to financial instruments that take the form of insurance contracts that involve the transfer of financial risk.

- Share based payment transactions are excluded from the scope of ED 38 except:
 - 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; and-

- Treasury shares purchased, sold, issued or cancelled.

Principle

IN9. 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 are 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 entity's own equity instruments do not include puttable financial instruments classified as equity instruments, instruments that impose on the entity an obligation to deliver to another party a pro-rata share of the net assets of the entity only on liquidation and are classified as equity instruments, or the issuer's own equity instruments that are themselves contracts for the future receipt or delivery of the issuer's own equity instruments.

IN10. 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.

IN11. 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

IN12. 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 IN9 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 (for example, a commodity price), the contract is not an equity instrument, but is a financial asset or a financial liability.

Puttable Instruments

IN13. 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, except if the instrument has certain features. Where certain features are evident in a puttable financial instrument, it is treated as an equity instrument and not a financial asset or a financial liability.

Obligations Arising on Liquidation

IN14. Some instruments impose an obligation on an entity to deliver a pro rata share of the net assets of that entity to another party only on liquidation. In certain instances, these instruments are classified as equity instruments rather than financial liabilities.

Contingent Settlement Provisions

IN15. 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

IN16. 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 of the settlement alternatives would result in it being an equity instrument.

Measurement of the Components of a Compound Financial Instrument on Initial Recognition

IN16. Previously, IPSAS 15 allowed entities to measure the liability component of a compound financial instrument on initial recognition either as a residual amount after separating the equity component, or by using a relative-fair-value method. ED 37 prescribes that any asset and liability components are separated first and the residual is the amount allocated to the component of net assets/equity. These requirements for separating the components of a compound financial instrument are conformed to both the definition of an equity instrument as a residual and the measurement requirements in ED 38.

Treasury Shares

IN17. Treasury shares arise when an entity re-acquires its own equity instruments. ED 37 clarifies that 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 or Similar Distributions, Losses and Gains

IN18. Transaction costs incurred as a necessary part of completing transactions in an entity's net assets/equity are accounted for as part of that transaction and are deducted from net assets/equity.

PROPOSED INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD ED 37 FINANCIAL INSTRUMENTS: PRESENTATION

Objective

~~{deleted}~~

IAS 32.1; paragraph deleted from IAS 32.

1. The objective of this Standard is to establish principles for presenting financial instruments as liabilities or net assets/equity and for offsetting financial assets and financial liabilities. It applies to the classification of financial instruments, from the perspective of the issuer, into financial 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.

IAS 32.2; amended wording to align with terminology used in other IPSASs.
2. The principles in this Standard complement the principles for recognizing and measuring financial assets and financial liabilities in ED 38, “Financial Instruments: Recognition and Measurement”, and for disclosing information about them in ED 39, “Financial Instruments: Disclosures”.

IAS 32.3; amended referencing from IASs to IPSASs.

Scope (see also paragraphs AG3-AG7)

3. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard to This Standard shall be applied by all entities to all types of financial instruments except:**

IAS 32.4; amended to add standard wording in IPSAS regarding the application of IPSAS by entities that apply accrual accounting.

 - (a) Those interests in controlled entities ~~subsidiaries~~, associates or joint ventures that are accounted for in accordance with ~~IAS 27~~ **IPSAS 6**, “Consolidated and Separate Financial Statements”, ~~IAS 28~~ **IPSAS 7**, “Investments in Associates” or ~~IPSAS 8~~, ~~IAS 31~~ “Interests in Joint Ventures”. However, in some cases, ~~IAS 27~~ **IPSAS 6**, ~~IAS 28~~ **IPSAS 7** or ~~IAS 31~~ **IPSAS 8** permits an entity to account for an interest in a controlled entity ~~subsidiary~~, associate or joint venture using ~~ED 38~~ **IAS 39**; in those cases, entities shall apply the requirements of this Standard. Entities shall also apply this Standard to all derivatives linked to interests in controlled entities ~~subsidiaries~~, associates or joint ventures.

IAS 32.4; amendments made for references to IPSAS and not IASs; changed terminology from subsidiary to controlled entity.
Amendments resulting from the 2007/08 Improvements Project have also been incorporated.
 - (b) Employers’ rights and obligations under employee benefit plans, to which **IPSAS 25**, ~~IAS 19~~ “Employee Benefits” applies.

IAS 32.4; amendments made for references to IPSAS and not IASs.
 - (c) ~~{deleted}~~

IAS 32.4(c) deleted from IAS 32
 - (c) **Obligations arising from insurance contracts. —as defined in the IFRS 4 insurance contracts. However, this Standard applies to:**

IAS 32.4; based on comment received, retained wording of existing IPSAS 15 with regards to the treatment of insurance contracts as the IPSASB has not addressed insurance contracts in the public sector yet. Added existing guidance from IPSAS 15

 - (i) **Financial guarantee contracts; and**
 - (ii) **Derivatives that are embedded in insurance**

~~contracts if ED 38 IAS 39 requires the entity to account for them separately. Moreover, an issuer shall apply this Standard to financial guarantee contracts if the issuer applies IAS 39 in recognizing and measuring the contracts, but shall apply the IFRS 4 if the issuer elects, in accordance with paragraph 4(d) of IFRS 4, to apply IFRS 4 in recognizing and measuring them.~~

With the exception in (ia) above, an entity may apply this Standard to other financial instruments that take the form of insurance contracts which involve the transfer of financial risk.

and the definition of insurance contracts in IFRS 4 to the Application Guidance explaining this issue.

All financial guarantees are to be treated as financial instruments and not insurance contracts. See the Basis for Conclusions for supporting rationale.

Included existing paragraph 6 of IPSAS 15 as Application Guidance. This paragraph encouraged entities to consider accounting for some insurance contracts as financial instruments, where the insurance contract involves the transfer of financial risk. Retained in ED 37 in the absence of an IPSAS on insurance contracts.

- (d) **Financial instruments that are within the scope of the international or national accounting standard dealing with insurance contracts IFRS 4** because they contain a discretionary participation feature. The issuer of these instruments is exempt from applying to these features paragraphs 13–37 and AG47–AG58 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 **ED 38 IAS 39**).

IAS 32.4; amendments made for references to IPSAS and not IASs.

- (e) **Financial instruments, contracts and obligations under share-based payment transactions to which the international or national accounting standard dealing with share-based payments IFRS 2 Share-based Payment** applies, except for:

IAS 32.4; amendments made for references to IPSAS and not IASs.

- (i) Contracts within the scope of paragraphs 4–6 of this Standard, to which this Standard applies;
- (ii) Paragraphs 38 and 39 of this Standard, which shall be applied to treasury shares purchased, sold, issued or cancelled in connection with employee share option plans, employee share purchase plans, and all other share-based payment arrangements.

~~[Deleted]~~

Paragraphs 5–7 of IAS 32 deleted.

4. **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.**

IAS 32.8; no amendment.

5. 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.

IAS 32.9; reference to a 'dealer's margin' in paragraph 5(c) is probably not appropriate as these situations are not likely to exist in

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 profit 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.

the public sector. However, wording retained in line with recommendations of the Zurich meeting.

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 4 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.

- 6. 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 5(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 entity's expected purchase, sale or usage requirements.

IAS 32.10; no amendment.

- 7. **This Standard applies to all public sector entities other than Government Business Enterprises.**

Added standard wording from IPSAS regarding the application of the standards to GBEs.

- 8. **The Preface to International Public Sector Accounting Standards issued by the International Public Sector Accounting Standards Board (IPSASB) explains that GBEs apply International Financial Reporting Standards, which are issued by the International Accounting Standards Board (IASB).**

Added standard wording from IPSAS regarding the application of the standards to GBEs.

Definitions (see also paragraphs AG8–AG46)

- 9. **The following terms are used in this Standard with the meanings specified:**

An equity instrument is any contract that evidences a

IAS 32.11; Changed ordering of definitions to be alphabetical in accordance with normal IPSASB drafting conventions.

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.

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

A **financial asset** is any asset that is:

- (a) Cash;
- (b) An equity instrument of another entity;
- (c) A contractual right:
 - (i) To receive cash or another financial asset from another entity; or
 - (ii) To exchange financial assets or financial liabilities with another entity under conditions that are potentially favorable to the entity; or
- (d) 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 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 puttable financial instruments classified as equity instruments in accordance with paragraphs 15 and 16, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 17 and 18, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.

Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

A **financial liability** is any liability that is:

- (a) A 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 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 puttable financial instruments classified as equity instruments in accordance with paragraphs 15 and 16, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 17 and 18, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.

Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraph 15 and 16 or paragraphs 17 and 18.

A puttable instrument is a financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset or is automatically put back to the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder.

Included definition of a puttable instrument as a result of amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

Terms defined in other International Public Sector Accounting Standards are used in this Standard with the same meanings as in those other Standards, and are reproduced in the Glossary of Defined Terms published separately.

Added standard wording to the definitions section.

10. The following terms are defined in paragraph 9 of ~~IAS 39-ED 38~~ and are used in this Standard with the meaning specified in that Standard.

IAS 32.12; amended referencing to IPSAS and amended for terminology used in ED 38.

- amortized cost of a financial asset or financial liability
- available-for-sale financial assets
- derecognizing
- derivative
- effective interest method
- financial asset or financial liability at fair value through ~~surplus or deficit~~ ~~profit or loss~~
- financial guarantee contract
- firm commitment
- forecast transaction
- hedge effectiveness
- hedged item
- hedging instrument
- held-to-maturity investments
- loans and receivables

- regular way purchase or sale
 - transaction costs.
11. In this Standard, ‘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 by law. Contracts, and thus financial instruments, may take a variety of forms and need not be in writing. IAS 32.13; no amendment.
12. In this Standard, ‘entity’ includes public sector entities, individuals, partnerships, incorporated bodies, and trusts. ~~and government agencies.~~ IAS 32.14; amended ‘government agencies’ to ‘public sector entities’.

Presentation

Liabilities and Net Assets/Equity (see also paragraphs AG47–AG52)

13. **The issuer of a financial instrument shall classify the instrument, or its component parts, on initial recognition as a financial liability, a financial asset or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial liability, a financial asset and an equity instrument.** IAS 32.15; no amendment.
14. When an issuer applies the definitions in paragraph 9 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. IAS32.16; no amendment.
- (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.
- (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 have all the features and meet the conditions described in paragraphs 15 and 16 or paragraphs 17 and 18, or instruments that are contracts for the future receipt or delivery of the issuer’s own equity instruments.
- Highlighted as part of the Application Guidance that these kinds of instruments are not likely to be common in the public sector.
- Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

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. As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraph 15 and 16 or paragraphs 17 and 18.

Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

Puttable Instruments

15. A puttable financial instrument includes a contractual obligation for the issuer to repurchase or redeem that instrument for cash or another financial asset on exercise of the put. As an exception to the definition of a financial liability, an instrument that includes such an obligation is classified as an equity instrument if it has all of the following features:

- (a) It entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation. The entity's net assets are those assets that remain after deducting all other claims on its assets. A pro rata share is determined by:
 - (i) Dividing the entity's net assets on liquidation into units of equal amount; and
 - (ii) Multiplying that amount by the number of the units held by the financial instrument holder.
- (b) The instrument is in the class of instruments that is subordinate to all other classes of instruments. To be in such a class the instrument:
 - (i) Has no priority over other claims to the assets of the entity on liquidation; and
 - (ii) Does not need to be converted into another instrument before it is in the class of instruments that is subordinate to all other classes of instruments.
- (c) All financial instruments in the class of instruments that is subordinate to all other classes of instruments have identical features. For example, they must all be puttable, and the formula or other method used to calculate the repurchase or redemption price is the same for all instruments in that class.
- (d) Apart from the contractual obligation for the issuer to repurchase or redeem the instrument for cash or another financial asset, the instrument does not include any contractual obligation to deliver cash or another financial asset to another entity, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity, and it is not a contract that will or may be settled in the entity's own equity instruments as set out in subparagraph (b) of the definition of a financial liability.
- (e) The total expected cash flows attributable to the instrument over the life of the instrument are based substantially on the surplus or deficit ~~profit or loss~~, the change in the recognized net assets or the change in the fair value of the recognized and unrecognized net assets of the entity over the life of the instrument (excluding

IAS 32.16A - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

Amended for public sector terminology.

any effects of the instrument).

16. For an instrument to be classified as an equity instrument, in addition to the instrument having all the above features, the issuer must have no other financial instrument or contract that has:

- (a) Total cash flows based substantially on the surplus or deficit ~~profit or loss~~, the change in the recognized net assets or the change in the fair value of the recognized and unrecognized net assets of the entity (excluding any effects of such instrument or contract); and
- (b) The effect of substantially restricting or fixing the residual return to the puttable instrument holders.

For the purposes of applying this condition, the entity shall not consider non-financial contracts with a holder of an instrument described in paragraph 15 that have contractual terms and conditions that are similar to the contractual terms and conditions of an equivalent contract that might occur between a non-instrument holder and the issuing entity. If the entity cannot determine that this condition is met, it shall not classify the puttable instrument as an equity instrument.

IAS 32.16B - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

Amended for public sector terminology: profit or loss to 'surplus or deficit'.

Instruments, or components of instruments, that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation

17. Some financial instruments include a contractual obligation for the issuing entity to deliver to another entity a pro rata share of its net assets only on liquidation. The obligation arises because liquidation either is certain to occur and outside the control of the entity (for example, a limited life entity) or is uncertain to occur but is at the option of the instrument holder. As an exception to the definition of a financial liability, an instrument that includes such an obligation is classified as an equity instrument if it has all of the following features:

- (a) It entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation. The entity's net assets are those assets that remain after deducting all other claims on its assets. A pro rata share is determined by:
 - (i) Dividing the net assets of the entity on liquidation into units of equal amount; and
 - (ii) Multiplying that amount by the number of the units held by the financial instrument holder.
- (b) The instrument is in the class of instruments that is subordinate to all other classes of instruments. To be in such a class the instrument:
 - (i) Has no priority over other claims to the assets of the entity on liquidation, and
 - (ii) Does not need to be converted into another instrument before it is in the class of instruments that is subordinate to all other classes of instruments.
- (c) All financial instruments in the class of instruments that is subordinate to all other classes of instruments must

IAS 32.16C - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

No amendment.

have an identical contractual obligation for the issuing entity to deliver a pro rata share of its net assets on liquidation.

18. For an instrument to be classified as an equity instrument, in addition to the instrument having all the above features, the issuer must have no other financial instrument or contract that has:
- (a) Total cash flows based substantially on the surplus or deficit ~~profit or loss~~, the change in the recognized net assets or the change in the fair value of the recognized and unrecognized net assets of the entity (excluding any effects of such instrument or contract); and
 - (b) The effect of substantially restricting or fixing the residual return to the instrument holders.

IAS 32.16D - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

Amended for public sector terminology: profit or loss to 'surplus or deficit'.

For the purposes of applying this condition, the entity shall not consider non-financial contracts with a holder of an instrument described in paragraph 17 that have contractual terms and conditions that are similar to the contractual terms and conditions of an equivalent contract that might occur between a non-instrument holder and the issuing entity. If the entity cannot determine that this condition is met, it shall not classify the instrument as an equity instrument.

Reclassification of puttable instruments and instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation

19. An entity shall classify a financial instrument as an equity instrument in accordance with paragraphs 15 and 16 or paragraphs 17 and 18 from the date when the instrument has all the features and meets the conditions set out in those paragraphs. An entity shall reclassify a financial instrument from the date when the instrument ceases to have all the features or meet all the conditions set out in those paragraphs. For example, if an entity redeems all its issued non-puttable instruments and any puttable instruments that remain outstanding have all of the features and meet all the conditions in paragraphs 15 and 16, the entity shall reclassify the puttable instruments as equity instruments from the date when it redeems the non-puttable instruments.

IAS 32.16E - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

No amendment.

20. An entity shall account as follows for the reclassification of an instrument in accordance with paragraph 19:

- (a) It shall reclassify an equity instrument as a financial liability from the date when the instrument ceases to have all of the features or meet the conditions in paragraphs 15 and 16 or paragraphs 17 and 18. The financial liability shall be measured at the instrument's fair value at the date of reclassification. The entity shall recognize in net assets/equity any difference between the carrying value of the equity instrument and the fair value of the financial liability at the date of reclassification.
- (b) It shall reclassify a financial liability as an equity instrument from the date when the instrument has all of the features and meets the conditions set out in paragraphs 15 and 16 or paragraphs 17 and 18. An equity instrument shall be measured at the carrying

IAS 32.16F - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

Amended for public sector terminology: profit or loss to 'net assets/equity'

value of the financial liability at the date of reclassification.

No Contractual Obligation to Deliver Cash or Another Financial Asset (paragraph 14(a))

21. With the exception of the circumstances described in paragraphs 15 and 16 or paragraphs 17 and 18, 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 financial assets or financial liabilities 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 declared, or distributions of the net assets/equity or other distributions of equity, 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.

IAS 32.17.Redrafted wording slightly to reflect the concept of ‘returns of or on capital’, while amending the references to ‘dividends or similar distributions’.

Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

22. The substance of a financial instrument, rather than its legal form, governs its classification on the entity’s statement of financial position. Substance and legal form are commonly consistent, but not always. Some financial instruments take the legal form of equity instruments ~~equity~~ but are liabilities in substance and others may combine features associated with equity instruments and features associated with financial liabilities. For example:

IAS 32.18; amended the word ‘equity’ to ‘equity instrument’ to be consistent with the remainder of the Standard, changed reference to net assets/equity.

Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

- (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.
- (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, except for those instruments classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18. The financial instrument is a financial liability 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. 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, except for those instruments classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18. 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, which results in the unitholders’ or members’ interests being classified as financial liabilities, except for those instruments classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18. 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 equity (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/equity and puttable instruments that do not (see Illustrative Example 8).

23. 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, except for those instruments classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18. For example:
- (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.
24. 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:
- (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.

IAS 32.19; no amendment. Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

IAS 32.20; no amendment.

Although the entity does not have an explicit contractual obligation to deliver cash or another financial asset, the value of the share settlement alternative is such that the entity will settle in cash. In any event, the holder has in substance been guaranteed receipt of an amount that is at least equal to the cash settlement option (see paragraph 25).

Settlement in the Entity’s Own Equity Instruments (paragraph 14(b))

25. 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 (for example, 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 ~~barrels of oil~~ ~~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.
26. Except as stated in paragraph 27, 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 asset/equity. Any consideration paid (such as the premium paid for a purchased option) is deducted directly from net assets/equity. Changes in the fair value of an equity instrument are not recognized in the financial statements.
27. If the entity's own equity instruments to be received, or delivered, by the entity upon settlement of a contract are puttable financial instruments with all of the features and meeting the conditions described in paragraphs 15 and 16, or instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation with all of the features and meeting the conditions described in paragraphs 17 and 18, the contract is a financial asset or a financial liability. This includes a contract that will be settled by the entity receiving or delivering a fixed number of such instruments in exchange for a fixed amount of cash or another financial asset.

IAS 32.21; amended example of gold to oil as the IPSASB will deal separately with gold as both a commodity and a currency in future financial instrument projects.

IAS 32.22; aligned terminology with other IPSASs.

Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

IAS 32.22A - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

28. With the exception of the circumstances described in paragraphs 15 and 16 or paragraphs 17 and 18, 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 ED 38 IAS 39, its fair value (the present value of the redemption amount) is reclassified from net assets/equity. Subsequently, the financial liability is measured in accordance with ED 38 IAS 39. If the contract expires without delivery, the carrying amount of the financial liability is reclassified to net assets/equity. An entity's contractual obligation to purchase its own equity instruments gives rise to a financial 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 (for example, 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).
29. 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 barrels of oil ~~ounces of gold~~.

IAS 32.23; aligned terminology with other IPSASs and amended referencing from IASs to IPSASs.

Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

IAS 32.24; amended example of gold to oil as the IPSASB will deal separately with gold as both a commodity and a currency in future financial instrument projects..

Contingent Settlement Provisions

30. 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~~ surplus or deficit or debt-to-equity 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;
 - (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; or
 - (c) The instrument has all of the features and meets the

IAS 32.25; deleted reference to 'net income' as this is not a measure used in the IPSASs, replaced net income with surplus or deficit in accordance with standard IPSASB terminology..

Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

conditions in paragraphs 15 and 16.

Settlement Options

31. **When a derivative financial instrument gives one party a choice over how it is settled (example 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.** IAS 32.26; no amendment.
32. 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 4–6). Such contracts are financial assets or financial liabilities and not equity instruments. IAS 32.27; no amendment.

Compound Financial Instruments (see also paragraphs AG53–AG58 and Illustrative Examples 9–12)

33. **The issuer of a non-derivative financial instrument shall evaluate the terms of the financial instrument to determine whether it contains both a liability component and a component of net assets/equity ~~an equity component~~. Such components shall be classified separately as financial liabilities, financial assets or equity instruments in accordance with paragraph 13.** IAS 32.28; amended wording to address the issue of 'equity components' in the public sector. As an alternative, the following is suggested: ...whether it contains both a liability and a net assets/equity component ~~an equity component~~.
34. An entity recognizes separately the components of a financial instrument that (a) creates a financial liability of the entity and (b) grants an option to the holder of the instrument to convert it into an equity instrument of the entity. For example, a bond or similar instrument convertible by the holder into a fixed number of ordinary shares of the entity is a compound financial instrument. From the perspective of the entity, such an instrument comprises two components: a financial liability (a contractual arrangement to deliver cash or another financial asset) and an equity instrument (a call option granting the holder the right, for a specified period of time, to convert it into a fixed number of ordinary shares of the 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 ordinary shares, or issuing a debt instrument with detachable share purchase warrants. Accordingly, in all cases, the entity presents the liability component and the component of net assets/equity ~~and equity components~~ separately in its statement of financial position. IAS 32.29; amended wording to address the issue of 'equity components' in the public sector.
As an alternative, the following is suggested: ...an entity presents the liability and net assets/equity components... ~~an equity component~~.
35. Classification of a convertible instrument into its the components liability and 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 IAS 32.30; redrafted sentence to reflect the notion of a component of net assets/equity rather than an 'equity component'.

when exercise of the option may appear to have become economically advantageous to some holders. Holders may not always act in the way that might be expected because, for example, the tax consequences resulting from conversion may differ among holders. Furthermore, the likelihood of conversion will change from time to time. The entity's contractual obligation to make future payments remains outstanding until it is extinguished through conversion, maturity of the instrument or some other transaction.

36. ~~ED 38 IAS 39~~ deals with the measurement of financial assets and financial liabilities. Equity instruments 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 into its ~~equity and liability~~ components, the component of net assets/equity 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 is included in the liability component unless it forms part of the component of net assets/equity other than the equity component (such as an equity conversion option) ~~is included in the liability component~~. The sum of the carrying amounts assigned to the liability component and the component of net assets/equity equity 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.
- IAS 32.31; amended wording to address the notion of net assets/equity components rather than 'equity components' in the public sector; aligned terminology with other IPSASs.
- Aligned text with other IPSASs; amended 'deals with' to 'addresses'.
37. Under the approach described in paragraph 36, the issuer of a bond convertible into ordinary shares first determines the carrying amount of the liability component by measuring the fair value of a similar liability (including any embedded non-equity derivative features) that does not have an associated ~~component of net assets/equity equity component~~. The carrying amount of the equity instrument represented by the option to convert the instrument into ordinary shares is then determined by deducting the fair value of the financial liability from the fair value of the compound financial instrument as a whole.
- IAS 32.32; amended wording to address the issue of 'equity components' in the public sector; changed other public sector terminology.

Treasury Shares (see also paragraph AG59)

38. **If an entity reacquires its own equity instruments, those instruments ('treasury shares') shall be deducted from net assets/equity. No gain or loss shall be recognized in surplus or deficit ~~profit or loss~~ 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 economic entity consolidated group. Consideration paid or received shall be recognized directly in net assets/equity.**
- IAS 32.33; amendments made to text for public sector terminology.
39. The amount of treasury shares held is disclosed separately either in the statement of financial position or in the notes, in accordance with IPSAS 1 ~~IAS 1~~, "Presentation of Financial Statements". An entity provides disclosure in accordance with IPSAS 20, ~~IAS 24~~ "Related Party Disclosures" if the
- IAS 32.34; amendments made to text for public sector terminology.

entity reacquires its own equity instruments from related parties.

Interest, Dividends or Similar Distributions, Losses and Gains (see also paragraph AG60)

40. **Interest, dividends or similar distributions, losses and gains relating to a financial instrument or a component that is a financial liability shall be recognized as ~~revenue income~~ or expense in surplus or deficit ~~profit or loss~~. Distributions to holders of an equity instrument shall be debited by the entity directly to net assets/equity, net of any related income tax benefit. Transaction costs incurred on transactions in net assets/equity of an equity transaction shall be accounted for as a deduction from net assets/equity, net of any related income tax benefit.**

IAS 32.35; redrafted sentence relating to costs of an equity transaction and aligned terminology with other IPSASs.
41. The classification of a financial instrument as a financial liability or an equity instrument determines whether interest, dividends or similar distributions, losses and gains relating to that instrument are recognized as revenue income or expense in surplus or deficit ~~profit or loss~~. Thus, dividends or similar distributions ~~payments~~ on shares wholly recognized as liabilities are recognized as expenses in the same way as interest on a bond. Similarly, gains and losses associated with redemptions or refinancings of financial liabilities are recognized in surplus or deficit ~~profit or loss~~, whereas redemptions or refinancings of equity instruments are recognized as changes in net assets/equity. Changes in the fair value of an equity instrument are not recognized in the financial statements.

IAS 32.36; aligned terminology with other IPSASs.
42. 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. Any related ~~The~~ transaction costs ~~of an equity transaction~~ are accounted for as a deduction from net assets/equity (net of any related income tax benefit) to the extent they are incremental costs directly attributable to the equity transaction that otherwise would have been avoided. The costs of ~~an equity~~ such a transaction that is abandoned are recognized as an expense.

IAS 32.37; wording amended to accommodate the notion of an 'equity transaction' in the public sector.
43. Transaction costs that relate to the issue of a compound financial instrument are allocated to the liability component and the component of net assets/equity ~~equity 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.

IAS 32.38; amended wording to accommodate 'equity components'; changed text to eliminate examples that are not public sector specific.
44. The amount of transaction costs accounted for as a deduction from net assets/equity in the period is disclosed separately under IPSAS 1, IAS 1. ~~The related amount of income taxes recognised directly in equity is included in the aggregate amount of current and deferred income tax credited or~~

IAS 32.39; amended to incorporate public sector terminology; deleted references to income taxes as these transactions do not commonly occur in the public sector.

~~charged to equity that is disclosed under IAS 12 *Income Taxes*.~~

45. Dividends or similar distributions classified as an expense are presented in the statement of financial performance ~~may be presented in the statement of comprehensive income or separate income statement (if presented)~~ 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-IAS 1 and ED 39 IFRS 7. In some circumstances, because of the differences between interest and dividends or similar distributions with respect to matters such as tax deductibility, it is desirable to disclose them separately in the statement financial performance of comprehensive income or separate income statement (if presented). ~~Disclosures of the tax effects are made in accordance with IAS 12.~~
46. Gains and losses related to changes in the carrying amount of a financial liability are recognized as revenue income or expense in surplus or deficit profit or loss 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 22(b)). Under IPSAS 1 IAS 1 the entity presents any gain or loss arising from remeasurement of such an instrument separately in the statement of financial performance comprehensive income when it is relevant in explaining the entity's performance.
- IAS 32.40; amended to incorporate public sector terminology; deleted references to income taxes as these transactions do not commonly occur in the public sector. Drafted the document on the basis that a statement of comprehensive income as envisaged in the revisions to IAS 1 does not exist in IPSAS 1. IAS 32 prior to the IAS 1 revisions required recognition of dividends paid in the income statement.
- IAS 32.41; amended to incorporate public sector terminology; drafted the document on the basis that a statement of comprehensive income as envisaged in the revisions to IAS 1 does not exist in IPSAS 1. IAS 32 prior to the IAS 1 revisions required recognition of such gains and losses in the income statement.

Offsetting a Financial Asset and a Financial Liability (see also paragraphs AG61 and AG62)

47. **A financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position when, and only when, an entity:**
- (a) **Currently 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.**
- 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 (see ED 38 IAS 39, paragraph 36XX).**
48. This Standard requires the presentation of financial assets and financial liabilities on a net basis when 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. In other circumstances, financial assets and financial liabilities are presented separately from each other consistently with their characteristics as resources or obligations of the entity.
49. Offsetting a recognized financial asset and a recognized
- IAS 32.42; no amendment.
- IAS 32.43; no amendment.
- IAS 32.44; no amendment.

financial liability and presenting the net amount differs from the derecognition of a financial asset or a financial liability. Although offsetting does not give rise to recognition of a gain or loss, the derecognition of a financial instrument not only results in the removal of the previously recognized item from the statement of financial position but also may result in recognition of a gain or loss.

50. 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 between the three parties that clearly establishes the debtor's right of set-off. Because the right of set-off is a legal right, the conditions supporting the right may vary from one legal jurisdiction to another and the laws applicable to the relationships between the parties need to be considered. IAS 32.45; no amendment.
51. 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 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 intends 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 because the rights and obligations associated with the individual financial asset and financial liability remain unaltered. IAS 32.46; no amendment.
52. An entity's intentions with respect to settlement of particular assets and liabilities may be influenced by its normal operating business 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 paragraph XX 36 of ED 39 IFRS 7. IAS 32.47; slight wording amendments to reflect public sector terminology.
53. 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 IAS 32.48; no amendment.

relatively brief. Accordingly, realization of a financial asset and settlement of a financial liability are treated as simultaneous only when the transactions occur at the same moment.

54. The conditions set out in paragraph 47 are generally not satisfied and offsetting is usually inappropriate when: IAS 32.49; no amendment.
- (a) Several different financial instruments are used to emulate the features of a single financial instrument (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 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 contract.
55. 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 may be ~~are commonly used by financial institutions to~~ provide protection against loss in the event of bankruptcy or other circumstances 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-business~~. A master netting arrangement does not provide a basis for offsetting unless both of the criteria in paragraph 47 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 36 of ED 39 ~~IFRS 7~~.
- IAS 32.50; aligned terminology with changes made in paragraph 45. Added in "may be" as these arrangements are not commonly used by all entities. Such netting arrangements exist, therefore deleted references to financial institutions.

Transitional Provisions

56. An entity shall apply this Standard retrospectively on first time application. However, where an entity previously did not apply IPSAS 15 (2001) or adopts accrual accounting for the first time, it need not present comparative information if such information is not Added transitional provision paragraph. Entities should apply the Standard retrospectively, with certain concessions made for those entities that previously did not apply IPSAS 15 or did not apply accrual accounting. This concession is

available:

based on the transitional provision in IPSAS 15 as well as previous versions of IAS 32.

57. When an entity that previously applied IPSAS 15 applies the requirements in paragraphs 15 to 18, an entity is required to split a compound financial instrument with an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation into a liability component and component of net assets/equity. If the liability component is no longer outstanding, a retrospective application of these requirements would involve separating two components of net assets/equity. The first component would be in accumulated surpluses and deficits and represent the cumulative interest accreted on the liability component. The other component would represent the original component of net assets/equity. Therefore, an entity need not separate these two components if the liability component is no longer outstanding when the Standard is adopted.
- Added transitional provision to provide entities relief relating to puttable instruments.
58. An entity that either previously did not apply IPSAS 15 or adopts accrual accounting for the first time, applies the transitional provision in paragraph 57 to all compound financial instruments.
- Added transitional provision to provide entities that move from a different reporting framework or basis of accounting additional relief for compound instruments.

Disclosure

~~{Deleted}~~

IAS 32 paragraphs 51-95 deleted.

Effective Date

59. An entity shall apply this International Public Sector Accounting Standard for annual financial statements covering periods beginning on or after Month, Day, Year. Earlier application is encouraged. If an entity adopts this Standard for a period beginning before Month, Day, Year, it shall disclose that fact.
- Added standard wording included in IPSAS.
60. An entity shall not apply this International Public Sector Accounting Standard before Month, Day, Year, unless it also applies ED 38 and ED 39.
- Added paragraph to explain the early adoption of the financial instrument standards as a package of Standards.
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.
- Standard wording in IPSASs.
- ~~An entity shall apply this Standard for annual periods beginning on or after 1 January 2005. Earlier application is permitted. An entity shall not apply this Standard for annual periods beginning before 1 January 2005 unless it also applies IAS 39 (issued December 2003), including the amendments issued in March 2004. If an entity applies this Standard for a period beginning before 1 January 2005, it shall disclose that fact.~~
- IAS 32.96; developed transitional provisions specifically for the IPSAS.

~~*Puttable Financial Instruments and Obligations Arising on Liquidation* (Amendments to IAS 32 and IAS 1), issued in February 2008, required financial instruments that contain all of the features and meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D to be classified as an equity instrument, amended paragraphs 11, 16, 17–19, 22, 23, 25, AG13, AG14 and AG27, and inserted paragraphs 16A–16F, 22A, 96B, 96C, 97C, AG14A–AG14J and AG29A. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies these changes for an earlier period, it shall disclose that fact and apply the related amendments to IAS 1, IAS 39, IFRS 7 and IFRIC 2 at the same time.~~

IAS 32.96A; developed transitional provisions specifically for the IPSAS.

~~*Puttable Financial Instruments and Obligations Arising on Liquidation* introduced a limited scope exception; therefore, an entity shall not apply the exception by analogy. Before paragraph 96, the heading is amended (new text is underlined). After paragraph 96, paragraphs 96A–96C are added. After paragraph 97B, paragraph 97C is added.~~

IAS 32.96B; developed transitional provisions specifically for the IPSAS.

~~The classification of instruments under this exception shall be restricted to the accounting for such an instrument under IAS 1, IAS 32, IAS 39 and IFRS 7. The instrument shall not be considered an equity instrument under other guidance, for example IFRS 2 *Share-based Payment*.~~

IAS 32.96C; developed transitional provisions specifically for the IPSAS.

~~This Standard shall be applied retrospectively.~~

IAS 32.97; developed transitional provisions specifically for the IPSAS.

~~IAS 1 (as revised in 2007) amended the terminology used throughout IFRSs. In addition it amended paragraph 40. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies IAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.~~

IAS 32.97A; developed transitional provisions specifically for the IPSAS.

~~IFRS 3 (as revised in 2008) deleted paragraph 4(c). An entity shall apply that amendment for annual periods beginning on or after 1 July 2009. If an entity applies IFRS 3 (revised 2008) for an earlier period, the amendment shall also be applied for that earlier period.~~

IAS 32.97B; developed transitional provisions specifically for the IPSAS.

~~When applying the amendments described in paragraph 96A, an entity is required to split a compound financial instrument with an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation into separate liability and equity components. If the liability component is no longer outstanding, a retrospective application of those amendments to IAS 32 would involve separating two components of equity. The first component would be in retained earnings and represent the cumulative interest accreted on the liability component. The other component would represent the original equity component. Therefore, an entity need not separate these two components if the liability component is no longer outstanding at the date of application of the amendments.~~

IAS 32.97C; developed transitional provisions specifically for the IPSAS.

Withdrawal and Replacement of IPSAS 15 (2001)

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| 62. | <u>This Standard replaces IPSAS 15, “Financial Instruments: Presentation and Disclosure” issued in 2001.</u> | Added standard wording. This may need to be amended depending on the decision to be taken in February 2009 regarding the withdrawal/replacement of IPSAS 15. |
| 98 | This Standard supersedes IAS 32 <i>Financial Instruments: Disclosure and Presentation</i> revised in 2000.¹ | IAS 32.98; paragraph specific to IPSAS 15 included. |
| 99 | This Standard supersedes the following Interpretations:
(a) SIC 5 <i>Classification of Financial Instruments—Contingent Settlement Provisions</i>;
(b) SIC 16 <i>Share Capital—Reacquired Own Equity Instruments (Treasury Shares)</i>; and
(c) SIC 17 <i>Equity—Costs of an Equity Transaction</i>. | IAS 32.99; paragraphs not relevant to IPSASs |
| 100 | This Standard withdraws draft SIC Interpretation D34 <i>Financial Instruments—Instruments or Rights Redeemable by the Holder</i>. | IAS 32.100; paragraph not relevant to IPSAS |

¹ In August 2005 the IASB relocated all disclosures relating to financial instruments to IFRS 7 *Financial Instruments: Disclosures*

Appendix A - Application Guidance

This appendix is an integral part of ED 37.

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| AG1 | This Application Guidance explains the application of particular aspects of the Standard. | IAS32.AG1; no amendment. |
| AG2 | The Standard does not deal with the recognition or measurement of financial instruments. Requirements about the recognition and measurement of financial assets and financial liabilities are set out in <u>ED 38 IAS 39</u> . | IAS32.AG1; amended referencing from IAS to IPSAS. |

Scope (paragraphs 3-6)

Financial Guarantee Contracts

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|------------|--|--|
| <u>AG3</u> | <p><u>Financial guarantee contracts are those contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original terms of a debt instrument. Governments may issue financial guarantees for a variety of reasons. They are often issued to further a government's policy objectives, for example, to create affordability in infrastructure projects and stabilize the financial market in times of distress. Governments and public sector entities may be granted the power to issue financial guarantees in terms of legislation or other authority. In assessing whether a guarantee is contractual or non-contractual, an entity distinguishes the right to issue the guarantee and the actual issue of the guarantee. The right to issue the guarantee in terms of legislation or other authority is non-contractual, while the actual issue of the guarantee should be assessed using the principles in paragraph AG18 to determine whether the guarantee is contractual or non-contractual.</u></p> | Added paragraph to clarify when financial guarantees are deemed to be contractual. |
| <u>AG4</u> | <p><u>The issuing of financial guarantees in favor of a third party, whether explicitly or implicitly, may result in a contractual arrangement. Financial guarantees may be issued to a specific party or they may be issued to the holder of an instrument. Consider the following two examples:</u></p> <ul style="list-style-type: none"> • <u>In a service concession arrangement, a government may issue a financial guarantee directly to the financiers of the transaction stating that, in the event of default, it would assume payment for any outstanding principal and interest payments of a loan. In this instance, the financial guarantee is explicitly issued in favor of an identified counterparty.</u> • <u>Road authority A is responsible for constructing and maintaining a country's road infrastructure. It finances the construction of new roads by issuing long term bonds. National government A exercises its powers in legislation and guarantees the bond issue of road authority A. At the time the guarantee is issued, there are no specific counterparties that have been identified, rather the guarantee is implicitly issued in favor of the holders of a specific instrument</u> | Added paragraph to clarify when financial guarantees are deemed to be contractual. |

In both these scenarios, assuming that all the other features of a contract are met, the financial guarantee is contractual in nature.

Insurance Contracts

AG5. Some economic entities in the public sector may include entities that issue insurance contracts. Those entities are within the scope of this Standard, but the insurance contracts themselves are outside the scope of this Standard.

Added principles of existing paragraph 6 of IPSAS 15 to explain the application of the Standard to insurance contracts. However, paragraph 6 was split into three paragraphs.

AG6 For the purposes of this Standard, an insurance contract is a contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) if a specified uncertain future event (the insured event) adversely affects the policyholder.

Added principles of existing paragraph 6 of IPSAS 15 to explain the application of the Standard to insurance contracts. However, paragraph 6 was split into three paragraphs. Rather than include the IPSAS 15 description of an insurance contract, included definition of an insurance contract from IFRS 4.

AG7 Some financial instruments take the form of insurance contracts but principally involve the transfer of financial risks, such as market, credit, or liquidity risk. Examples of such instruments include financial guarantee contracts, reinsurance and guaranteed investment contracts issued by public sector insurers and other entities. An entity is required to apply this Standard to financial guarantee contracts, and is encouraged to apply this Standard to other insurance contracts that involve the transfer of financial risk.

Added principles of existing paragraph 6 of IPSAS 15 to explain the application of the Standard to insurance contracts. However, paragraph 6 was split into three paragraphs, and excluded the text that dealt with the encouraged application of financial instruments to obligations arising from insurance contracts. Clarified that this Standard is mandatory for financial guarantee contracts.

Definitions (paragraphs 9–12)

Financial Assets and Financial Liabilities

AG8 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 recognized 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. Unissued currency held by a central bank does not meet the definition of a financial instrument. An entity applies IPSAS 12, "Inventories" in accounting for any unissued currency. Currency that has been issued by a central bank, i.e. notes and coins in circulation, is not addressed in this Standard.

IAS32.AG3; clarified the application of this Standard to cash held by a central bank.

AG9 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:

IAS32.AG4; deleted the word 'trade' receivables.

- (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).

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| AG10 | 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 government bonds gives the holder the contractual right to receive and the issuer the contractual obligation to deliver government bonds, not cash. The bonds are financial assets because they represent obligations of the issuing government to pay cash. The note is, therefore, a financial asset of the note holder and a financial liability of the note issuer. | IAS32.AG5; no amendment. |
| AG11 | ‘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 per cent applied to a stated par or principal amount of CU1,000. Assuming 8 per cent 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 a financial liability, respectively. | IAS32.AG6; no amendment. |
| A12 | 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. | IAS32.AG7; no amendment. |
| AG13 | 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 IFRS 4. | IAS32.AG8; deleted reference to IFRS 4. |

- AG14 Under IPSAS 13, "Leases" ~~IAS 17 Leases~~ a finance lease is 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 regarded as 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 regarded as a financial instrument and an operating lease is not regarded as a financial instrument (except as regards individual payments currently due and payable). IAS32.AG9; amended references from IASs to IPSASs.
- AG15 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. IAS32.AG10; no amendment.
- AG16 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. IAS32.AG11; no amendment.
- AG17 Assets and liabilities in the public sector arise out of both contractual and non-contractual arrangements. Assets and liabilities arising out of non-contractual arrangements are not financial assets or financial liabilities.
~~Liabilities or assets that are not contractual (such as income taxes) that are created as a result of statutory requirements imposed by governments) are not financial liabilities or financial assets. Accounting for income taxes is dealt with in IAS 12. Similarly, constructive obligations, as defined in IAS 37 Provisions, Contingent Liabilities and Contingent Assets, do not arise from contracts and are not financial liabilities.~~ IA 32.AG12; clarified that assets and liabilities can arise out of both contractual and non-contractual arrangement, , and separated the discussion on statutory and constructive obligations.
- AG18 Contractual arrangements, for the purposes of this Standard, are generally evidenced by the following (although this may differ from jurisdiction to jurisdiction):
 - Contractual arrangements typically involve willing parties entering into an arrangement. This means that arrangements that compel parties to transact with one another, such as when a government levies taxes on its citizens, are non-contractual in nature.
 - The terms of the contract create rights and obligations for the parties to the contract, and those rights and
Added paragraph to clarify what the features of a contractual arrangement in the public sector may constitute.

obligations need not result in equal performance by each party. For example, a donor funding arrangement creates an obligation for the donor to transfer resources to the recipient in terms of the agreement concluded, and establishes the right of the recipient to receive those resources. These types of arrangements may be contractual even though the recipient did not provide equal consideration in return i.e. the arrangement does not result in equal performance by the parties; and

- The contract is enforceable by law.

AG19 Non-contractual, non-exchange revenue transactions are initially recognized and measured in accordance with IPSAS 23, “Revenue from Non-Exchange Transactions (Taxes and Transfers)”. If non-exchange revenue transactions are contractual and otherwise meet the definition of a financial asset, the principles in this Standard are also applied.

Added paragraph to clarify ~~the~~ accounting requirements for contractual and non-contractual non-exchange revenue transactions.

Note: This will require a consequential amendment to the text of IPSAS 23 dealing with this issue.

AG20 An entity would particularly consider the classification requirements of this Standard in determining whether an inflow of resources as part of a contractual non-exchange revenue transaction is in substance a liability or an equity instrument.

Added paragraph to clarify that entities should also consider the requirements of this Standard for receivables arising from contractual non-exchange revenue transactions, specifically the classification thereof into either liabilities or residual interests.

Note: A consequential amendment to the text of IPSAS 23 has been proposed dealing with this issue.

AG21 Statutory obligations can be accounted for in a number of ways:

- Obligations to pay income taxes are accounted for in accordance with the international or national accounting standard dealing with income taxes.
- Obligations to provide social benefits are accounted for in accordance with IPSAS 3 “Accounting Policies, Changes in Accounting Estimates and Errors” and IPSAS 19, “Accounting Policies, Changes in Accounting Estimates and Errors”.
- Other statutory obligations are accounted for in accordance with IPSAS 19, “Provisions, Contingent Liabilities and Contingent Assets”.

Added paragraph to clarify how statutory obligations are accounted for. Text relating to the treatment of taxes taken from IAS 32.AG12.

AG22 Constructive obligations, as defined in IPSAS 19, also do not arise from contracts and are therefore not financial liabilities.

Text separated from original IAS 32.AG12.

Equity Instruments

AG23 It is not common for entities in the public sector to have contributed capital comprising equity instruments, for example, shares and other forms of unitized capital. Where entities do issue equity instruments, the ownership and use of those instruments may be restricted by legislation. For

Added paragraph to explain the use of equity instruments in the public sector.

example, legislation may stipulate that shares in a public sector entity may only be owned by another public sector entity and may therefore not be used as consideration for the settlement of transactions.

AG24 Contributed capital in the public sector may also be evidenced by transfers of resources between parties. Transfers of resources that result in an interest in the net assets/equity of an entity are distinguished from other transfers of resources because they may be evidenced by the following:

- A formal designation of a transfer of resources (or a class of such transfers) by the parties to the transaction as forming part of an entity's net assets/equity, either before the contribution occurs or at the time of the contribution. For example, on establishing a new entity, the budget office of the department of finance may deem that the initial transfers of resources to an entity establish an interest in the net assets/equity of an entity rather than provide funding to meet operational requirements.

A formal agreement, in relation to the transfer, establishing or increasing an existing financial interest in the net assets/equity of an entity that can be sold, transferred or redeemed. Even though transfers of resources may be evidenced by a designation or formal agreement, an entity assesses the nature of transfers of resources based on their substance and not merely their legal form.

IPSAS 23 acknowledges the different forms of 'capital' that exist in the public sector in paragraph 38. The two bullets in this paragraph have been drawn from IPSAS 23.38.

AG25 For the purposes of this Standard, the term "equity instrument" may be used to denote the following:

- A form of unitized capital such as ordinary or preference shares;
- Transfers of resources (either designated or agreed as such between the parties to the transaction) that evidence a residual interest in the net assets of another entity; and/or
- Financial liabilities in the legal form of debt that, in substance, represent an interest in entity's net assets.

Added paragraph to clarify that "equity instruments" refers to all instruments that evidence a residual interest in the net assets of an entity, including some liabilities.

Puttable Instruments

AG26 Where an entity's contributed capital is comprised of shares or other forms of unitized capital, these instruments may take a number of forms, e.g., of equity instruments include non-puttable ordinary shares, some puttable instruments (see paragraphs 15 and 16), some instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation (see paragraphs 17 and 18), some types of preference shares (see paragraphs AG47 and AG48), and warrants or written call options that allow the holder to subscribe for or purchase a fixed number of non-puttable ordinary 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

IAS32.AG13; redrafted slightly based on the previous paragraph.

Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation. Amended reference to "equity" to "an equity instrument".

asset is an equity instrument of the entity (except as stated in paragraph 27). However, if such a contract contains an obligation for the entity to pay cash or another financial asset (other than a contract classified as an equity instrument in accordance with paragraphs 15 and 16 or paragraphs 17 and 18), it also gives rise to a liability for the present value of the redemption amount (see paragraph AG49(a)). An issuer of non-puttable ordinary shares assumes a liability when it formally acts to make a distribution and becomes legally obliged to the shareholders to do so. This may be the case following the 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.

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| AG27 | A purchased call option or other similar contract acquired by an entity that gives it the right to reacquire a fixed number of its own equity instruments in exchange for delivering a fixed amount of cash or another financial asset is not a financial asset of the entity (except as stated in paragraph 27). Instead, any consideration paid for such a contract is deducted from <u>net assets/equity</u> . | IAS32.AG14; amended terminology to be public sector specific.

Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation. |
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The class of instruments that is subordinate to all other classes (paragraphs 15(b) and 16(b))

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| AG28 | One of the features of paragraphs 15 and 16 is that the financial instrument is in the class of instruments that is subordinate to all other classes. | IAS32.AG14A - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation. No amendment to text. |
| AG29 | When determining whether an instrument is in the subordinate class, an entity evaluates the instrument's claim on liquidation as if it were to liquidate on the date when it classifies the instrument. An entity shall reassess the classification if there is a change in relevant circumstances. For example, if the entity issues or redeems another financial instrument, this may affect whether the instrument in question is in the class of instruments that is subordinate to all other classes. | IAS32.AG14B - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation. No amendment to text. |
| AG30 | An instrument that has a preferential right on liquidation of the entity is not an instrument with an entitlement to a pro rata share of the net assets of the entity. For example, an instrument has a preferential right on liquidation if it entitles the holder to a fixed dividend on liquidation, in addition to a share of the entity's net assets, when other instruments in the subordinate class with a right to a pro rata share of the net assets of the entity do not have the same right on liquidation. | IAS32.AG14C - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation. No amendment to text. |
| AG31 | If an entity has only one class of financial instruments, that class shall be treated as if it were subordinate to all other classes. | IAS32.AG14D - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation. No amendment to text. |

Total expected cash flows attributable to the instrument over the life of the instrument (paragraph 15(e))

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| AG32 | The total expected cash flows of the instrument over the life | AG32.AG14E - Included amendments made to |
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of the instrument must be substantially based on the surplus or deficit ~~profit or loss~~, change in the recognised net assets or fair value of the recognised and unrecognised net assets of the entity over the life of the instrument. Surplus or deficit ~~Profit or loss~~ and the change in the recognised net assets shall be measured in accordance with relevant IPSASs ~~IFRSs~~.

IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation. Amended for public sector terminology.

Transactions entered into by an instrument holder other than as owner of the entity (paragraphs 15 and 17)

AG33 The holder of a puttable financial instrument or an instrument that imposes on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation may enter into transactions with the entity in a role other than that of an owner. For example, an instrument holder also may be an employee of the entity. Only the cash flows and the contractual terms and conditions of the instrument that relate to the instrument holder as an owner of the entity shall be considered when assessing whether the instrument should be classified as an equity instrument under paragraph 15 or paragraph 17.

AG32.AG14F - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation. Amended for public sector terminology.

AG34 An example is a limited partnership that has limited and general partners. Some general partners may provide a guarantee to the entity and may be remunerated for providing that guarantee. In such situations, the guarantee and the associated cash flows relate to the instrument holders in their role as guarantors and not in their roles as owners of the entity. Therefore, such a guarantee and the associated cash flows would not result in the general partners being considered subordinate to the limited partners, and would be disregarded when assessing whether the contractual terms of the limited partnership instruments and the general partnership instruments are identical.

AG32.AG14G - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

AG35 Another example is ~~a revenue or surplus or deficit profit or loss~~ sharing arrangement that allocates surpluses and deficits ~~profit or loss~~ to the instrument holders on the basis of services rendered or business generated during the current and previous years. Such arrangements are transactions with instrument holders in their role as non-owners and should not be considered when assessing the features listed in paragraph 15 or paragraph 17. However, such profit or loss sharing arrangements that allocate surpluses and deficits ~~profit or loss~~ to instrument holders based on the nominal amount of their instruments relative to others in the class represent transactions with the instrument holders in their roles as owners and should be considered when assessing the features listed in paragraph 15 or paragraph 17.

AG32.AG14H - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

Amended terminology to be more public sector specific.

AG36 The cash flows and contractual terms and conditions of a transaction between the instrument holder (in the role as a non-owner) and the issuing entity must be similar to an equivalent transaction that might occur between a non-instrument holder and the issuing entity.

AG32.AG14I - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

No other financial instrument or contract with total cash flows that substantially fixes or restricts the residual return to the instrument holder (paragraphs 16 and 18)

- AG37 A condition for classifying an equity instrument as a financial instrument—that otherwise meets the criteria in paragraph 15 or paragraph 17 is that the entity has no other financial instrument or contract that has (a) total cash flows based substantially on the surplus or deficit ~~profit or loss~~, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity and (b) the effect of substantially restricting or fixing the residual return. The following instruments, when entered into on normal commercial terms with unrelated parties, are unlikely to prevent instruments that otherwise meet the criteria in paragraph 15 or paragraph 17 from being classified as equity instruments:
- (a) Instruments with total cash flows substantially based on specific assets of the entity.
 - (b) Instruments with total cash flows based on a percentage of revenue.
 - (c) Contracts designed to reward individual employees for services rendered to the entity.
 - (d) Contracts requiring the payment of an insignificant percentage of profit for services rendered or goods provided.
- AG32.AG14I - Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.
Amended for public sector terminology.

Derivative Financial Instruments

- AG38 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. IAS32.AG15; no amendment.
- AG39 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 contractual obligation to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavorable. However, they generally² do not result in a transfer of the underlying primary financial instrument on inception of the contract, nor does such a 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 IAS32.AG16; no amendment.

² 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).

either favorable or unfavorable.

- AG40 A put or call option to exchange financial assets or financial liabilities (i.e. financial instruments other than an entity's own equity 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 forgo 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 constitute a financial asset of the holder if the option were exercised. The option-holder's right to exchange the financial asset under potentially favorable conditions and the writer's obligation to exchange the financial asset under potentially unfavorable conditions are distinct from the underlying financial asset to be exchanged upon exercise of the option. The nature of the holder's right and of the writer's obligation are not affected by the likelihood that the option will be exercised. IAS32.AG17; no amendment.
- AG41 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 effect will be the opposite. The purchaser has 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. IAS32.AG18; no amendment.
- AG42 Many other types of derivative instruments embody a right or obligation to make a future exchange, including interest IAS32.AG19; no amendment.

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.

Contracts to Buy or Sell Non-Financial Items (paragraphs 4-6)

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| AG43 | 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, contracts that provide for settlement only by the receipt or delivery of a non-financial item (for example, an option, futures or forward contract on oil 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 bought and sold readily for cash because it is listed 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 4). | IAS32.AG20; amended example to be more public sector specific. |
| AG44 | A contract that involves the 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. | IAS32.AG21; amendment of wording for the public sector. |
| AG45 | Some contracts are commodity-linked, but do not involve settlement through the 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 | IAS32.AG22; no amendment. |

instrument.

- AG46 The definition of a financial instrument also encompasses a contract that gives rise to a non-financial asset or non-financial liability in addition to a financial asset or financial 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 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.

IAS32.AG23; no amendment.

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IAS 32.AG24; paragraph deleted from IAS 32.

Presentation

Liabilities and Net Assets/Equity (paragraphs 13-32)

No Contractual Obligation to Deliver Cash or Another Financial Asset (paragraphs 21-24)

- AG47 Preference shares may be issued with various rights. In determining whether a preference share is a financial liability or an equity instrument, an issuer assesses the particular rights attaching to the share to determine whether it exhibits the fundamental characteristic of a financial liability. For example, a preference share that provides for redemption on a specific date or at the option of the holder contains a financial liability because 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 preference share when contractually required to do so, whether because of a lack of funds, a statutory restriction or insufficient ~~surpluses—profits~~ 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 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.
- AG48 When preference shares are non-redeemable, the appropriate classification is determined by the other rights that 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 preference shares, whether cumulative or non-cumulative, are at the discretion

IAS32.AG25; clarified in paragraph AG 22 that the issue of equity instruments may not be common in the public sector, therefore only terminology amendments proposed to this paragraph.

IAS32.AG26: aligned terminology with other IPSASs.

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:

- (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 on the ordinary shares if dividends 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 ~~profit or loss~~ for a period; or
- (f) An ability or inability of the issuer to influence the amount of its surplus or deficit ~~profit or loss~~ for the period.

Settlement in the Entity's Own Equity Instruments (paragraphs 25-29)

AG49 As noted in paragraph AG23, it is not common for entities in the public sector to issue equity instruments comprising shares or other forms of unitized capital; and where such instruments do exist, their use and ownership is usually restricted in legislation. As a result of the capital structure of public sector entities generally being different from private sector entities and the legislative environment in which public sector entities operate, transactions that are settled in an entity's own equity instruments are not likely to occur as frequently in the public sector as in the private sector. However, where such transactions do occur, the following examples may assist in illustrating—how to classify different types of contracts on an entity's own equity instruments:

- (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 (except as stated in paragraph 27). Accordingly, any consideration received or paid for such a contract is added directly to or deducted directly from net assets/equity. 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 (with the exception of instruments that have all the features and meet the conditions in paragraph 15 and 16 or paragraphs 17 and 18). 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

IAS32.AG27; clarified that these kinds of transactions are not common in the public sector; amended for public sector terminology and replaced "gold" with "oil".

Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.

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 (except as stated in paragraphs 15 and 16 or paragraphs 17 and 18). 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 equity instruments (except as stated in paragraphs 15 and 16 or paragraphs 17 and 18). 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 oil ~~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 oil ~~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 (paragraph 30)

- AG50 Paragraph 30 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.
- IAS32.AG28; no amendment.

Treatment in Consolidated Financial Statements

- AG51 In consolidated financial statements, an entity presents non-controlling interests—i.e. the interests of other parties in the net assets/equity and revenue income—of its controlled entities subsidiaries—in accordance with IPSAS 1 IAS 4 and IPSAS 6 IAS 27. 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-group and the holders of the instrument in determining whether the economic entity group—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 subsidiary in a group issues a financial instrument and a controlling entity parent or other entity within the economic group—entity agrees additional terms directly with the holders of the instrument (for example, a guarantee), the economic entity-group may not have discretion over distributions or redemption. Although the controlled entity subsidiary—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 group 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-group—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.
- AG52 Some types of instruments that impose a contractual obligation on the entity are classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18. Classification in accordance with those paragraphs is an exception to the principles otherwise applied in this Standard to the classification of an instrument and cannot be applied by analogy to other instruments. This exception is not extended to the classification of non-controlling interests in the consolidated financial statements. Therefore, instruments classified as equity instruments in accordance with either paragraphs 15 and 16 or paragraphs 17 and 18 in the separate or individual financial statements that are non-controlling interests are classified as liabilities in the consolidated financial statements of the economic entity group.
- IAS32.AG29; aligned terminology with other IPSASs.
- IAS 32.29A. Included amendments made to IAS 32 in February 2008 relating to puttable financial instruments and obligations arising on liquidation.
- Added wording from paragraph 96B of the amendments to IAS 32 (part of the transitional provisions), to clarify that the exceptions may not be applied to other transactions by analogy. Amended for public sector terminology.

Compound Financial Instruments (paragraphs 33-37)

- AG53 Paragraph 33 applies only to issuers of non-derivative compound financial instruments. Paragraph 33 does not deal with compound financial instruments from the perspective of holders. ED 38 IAS 39 deals with the separation of embedded derivatives from the perspective of holders of compound financial instruments that contain the features of both debt and equity instruments. debt and equity features.
- IAS32.AG30; amended referencing from IAS to IPSAS, and amended wording to accommodate the concept of “equity components” in the public sector.

- AG54 Compound financial instruments are not common in the public sector because of the capital structure of public sector entities. The following discussion does however illustrate how a compound financial instrument would be analyzed into its component parts. A common form of compound financial instrument is a debt instrument with an embedded conversion option, such as a bond convertible into ordinary shares of the issuer, and without any other embedded derivative features. Paragraph 33 requires the issuer of such a financial instrument to present the liability component and the component of net assets/equity component separately in the statement of financial position, as follows:
- (a) The issuer's obligation to make scheduled payments of interest and principal is a financial liability that exists as long as the instrument is not converted. On 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 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.
- AG55 On conversion of a convertible instrument at maturity, the entity derecognizes the liability component and recognizes it as net assets/equity. The original equity component of net assets/equity remains as net assets/equity (although it may be transferred from one line item within net assets/equity to another). There is no gain or loss on conversion at maturity.
- AG56 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 equity~~ 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 33-37.
- AG57 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 ~~profit or loss~~; and
- IAS32.AG31; added wording to clarify the compound financial instruments are not common in the public sector; amended wording to refer to components of net assets.
- IAS32.AG32; aligned wording with other IPSASs.
- IAS32.AG33; deleted references to liability and equity components as the terminology used in this IPSAS is different (liability component and component of net assets/equity).
- IAS32.AG34; aligned terminology with other IPSASs.

- (b) The amount of consideration relating to the component of net assets/equity ~~component~~ is recognized in net assets/equity.

- AG58 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 ~~profit or loss~~. IAS32.AG35; aligned terminology with other IPSASs.

Treasury Shares (paragraphs 38 and 39)

- AG59 An entity's own equity instruments are not recognized as a financial asset regardless of the reason for which they are reacquired. Paragraph 38 requires an entity that reacquires its own equity instruments to deduct those equity instruments from net assets/equity. However, when an entity holds its own equity instruments on behalf of others, for example, a financial institution holding its own equity instruments 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. IAS32.AG36; retained reference to 'equity instruments' as it is not likely that these transactions will take place with other forms of contributed capital.

Interest, Dividends or Similar Distributions, Losses and Gains (paragraphs 40–46)

- AG60 The following example illustrates the application of paragraph 40 to a compound financial instrument. Assume that a non-cumulative preference share is mandatorily redeemable for cash in five years, but that dividends 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 ~~profit or loss~~ and classified as interest expense. Any dividends paid relate to the component of net assets/equity ~~component~~ and, accordingly, are recognized as a distribution of surplus or deficit ~~profit or loss~~. 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 (for example, a 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 expense. IAS32.AG37; amended for public sector terminology; retained references to shares & dividends in instances to be consistent with the example used. Amended reference to dividends or similar distributions where used more generally.

Offsetting a Financial Asset and a Financial liability (paragraphs 47–55)

- AG61 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 IAS32.AG38; no amendment.

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.

- AG62 The Standard does not provide special treatment for so-called ‘synthetic instruments’, which are groups 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 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 financial instrument is exposed to risks that may differ from the risks to which other financial instruments are exposed. Accordingly, when one financial instrument in a ‘synthetic instrument’ is an asset and another is a liability, they are not offset and presented in an entity’s statement of financial position on a net basis unless they meet the criteria for offsetting in paragraph 47.
- IAS32.AG39; no amendment.

Disclosure

~~Financial Assets and Financial Liabilities at Fair Value Through Profit or Loss (paragraph 94(f))~~

~~{Deleted}~~

IAS 32.AG40; deleted from IAS 32.

Appendix B - Members' Shares in Co-Operative Entities and Similar Instruments

This appendix is an integral part of ED 37.

Introduction

- 1 Co-operatives and other similar entities are formed by groups of persons to meet common economic or social needs. National laws typically define a co-operative as a society endeavouring to promote its members' economic advancement by way of a joint business operation (the principle of self-help). Members' interests in a co-operative are often characterised as members' shares, units or the like, and are referred to below as 'members' shares'. This Appendix applies to financial instruments issued to members of co-operative entities that evidence the members' ownership interest in the entity and does not apply to financial instruments that will or may be settled in the entity's own equity instruments.
- 2 ED 37 IAS 32 establishes principles for the classification of financial instruments as financial liabilities or net assets/equity. In particular, those principles apply to the classification of puttable instruments that allow the holder to put those instruments to the issuer for cash or another financial instrument. The application of those principles to members' shares in co-operative entities and similar instruments is difficult. This guidance is provided to illustrate the application of the principles in ED 37. Some of the International Accounting Standards Board's constituents have asked for help in understanding how the principles in IAS 32 apply to members' shares and similar instruments that have certain features, and the circumstances in which those features affect the classification as liabilities or net assets/equity.

Scope

~~3 This Interpretation applies to financial instruments within the scope of IAS 32, including financial instruments issued to members of co-operative entities that evidence the members' ownership interest in the entity. This Interpretation does not apply to financial instruments that will or may be settled in the entity's own equity instruments.~~

Issue

- 3 ~~4~~ Many financial instruments, including members' shares, have characteristics of equity instruments, including voting rights and rights to participate in dividend or similar distributions. Some financial instruments give the holder the right to request redemption for cash or another financial asset, but may include or be subject to limits on whether the financial instruments will be redeemed. The following paragraphs outline ~~How should~~ those redemption terms should be evaluated in determining whether the financial instruments should be classified as liabilities or net assets/equity.²

Consensus

Application of IPSASs to Members' Shares in Co-Operative Entities and Similar Instruments

- 4 ~~5~~ The contractual right of the holder of a financial instrument (including members' shares in co-operative entities) to request redemption does not, in itself, require that financial instrument to be classified as a financial liability. Rather, the entity must consider all of the terms and conditions of the financial instrument in determining its classification as a financial liability or an equity instrument. Those terms and conditions include relevant local laws, regulations and the entity's governing charter in effect at the date of classification, but not expected future amendments to those laws, regulations or charter.
- 5 ~~6~~ Members' shares that would be classified as equity instruments if the members did not have a right to request redemption are equity instruments if either of the conditions described in paragraphs 6 and 7 is present or the members' shares have all the features and meet the conditions in paragraphs 15 and 16 or paragraphs 17 and 18 of ED 37 IAS 32. Demand deposits, including current accounts, deposit accounts and similar contracts that arise when members act as customers are financial liabilities of the entity.
- 6 ~~7~~ Members' shares are equity instruments if the entity has an unconditional right to refuse redemption of the members' shares.
- 7 ~~8~~ Local law, regulation or the entity's governing charter can impose various types of prohibitions on the redemption of members' shares, e.g. unconditional prohibitions or prohibitions based on liquidity criteria. If redemption is unconditionally prohibited by local law, regulation or the entity's governing charter, members' shares are equity instruments. However, provisions in local law, regulation or the entity's governing charter that prohibit redemption only if conditions—such as liquidity constraints—are met (or are not met) do not result in members' shares being equity instruments.
- 8 ~~9~~ An unconditional prohibition may be absolute, in that all redemptions are prohibited. An unconditional prohibition may be partial, in that it prohibits redemption of members' shares if redemption would cause the number of members' shares or amount of paid-in capital from members' shares to fall below a specified level. Members' shares in excess of

the prohibition against redemption are liabilities, unless the entity has the unconditional right to refuse redemption as described in paragraph 6 or the members' shares have all the features and meet the conditions in paragraphs 15 and 16 or paragraphs 17 and 18 of ED 37 IAS 32. In some cases, the number of shares or the amount of paid-in capital subject to a redemption prohibition may change from time to time. Such a change in the redemption prohibition leads to a transfer between financial liabilities and net assets/equity.

- 9 ~~10~~ At initial recognition, the entity shall measure its financial liability for redemption at fair value. In the case of members' shares with a redemption feature, the entity measures the fair value of the financial liability for redemption at no less than the maximum amount payable under the redemption provisions of its governing charter or applicable law discounted from the first date that the amount could be required to be paid (see example 3).
- 10 ~~11~~ As required by paragraph 40 of ED 37 IAS 32, distributions to holders of equity instruments are recognised directly in net assets/equity, net of any income tax benefits. Interest, dividends or similar distributions and other returns relating to financial instruments classified as financial liabilities are expenses, regardless of whether those amounts paid are legally characterised as dividends or similar distributions, interest or otherwise.
- 11 ~~12~~ When a change in the redemption prohibition leads to a transfer between financial liabilities and net assets/equity, the entity shall disclose separately the amount, timing and reason for the transfer.
- 11 ~~13~~ The following ~~Appendix, which is an integral part of the consensus, provides~~ examples illustrate the of the application of the preceding paragraphs ~~this consensus~~.

Illustrative Examples

~~This appendix sets out seven examples of the application of the IFRIC consensus. The examples do not constitute an exhaustive list; other fact patterns are possible. Each example assumes that there are no conditions other than those set out in the facts of the example that would require the financial instrument to be classified as a financial liability and that the financial instrument does not have all the features or does not meet the conditions in paragraph 15 and 16 or paragraphs 17 and 18 of ED 37 IAS 32.~~

Unconditional right to refuse redemption (paragraph 6)

Example 1

Facts

- 12 ~~A2~~ The entity's charter states that redemptions are made at the sole discretion of the entity. The charter does not provide further elaboration or limitation on that discretion. In its history, the entity has never refused to redeem members' shares, although the governing board has the right to do so.

Classification

- 13 ~~A3~~ The entity has the unconditional right to refuse redemption and the members' shares are equity instruments. ED 37 IAS 32 establishes principles for classification that are based on the terms of the financial instrument and notes that a history of, or intention to make, discretionary payments does not trigger liability classification. Paragraph AG48 of ED 37 IAS 32 states:

When preference shares are non-redeemable, the appropriate classification is determined by the other rights that 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 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:

- (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 on the ordinary shares if dividends 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 ~~profit or loss~~ for a period; or
- (f) An ability or inability of the issuer to influence the amount of its surplus or deficit ~~profit or loss~~ for the period.

Example 2

Facts

- 14 ~~A4~~–The entity’s charter states that redemptions are made at the sole discretion of the entity. However, the charter further states that approval of a redemption request is automatic unless the entity is unable to make payments without violating local regulations regarding liquidity or reserves.

Classification

- 15 ~~A5~~–The entity does not have the unconditional right to refuse redemption and the members’ shares are classified as a financial liability. The restrictions described above are based on the entity’s ability to settle its liability. They restrict redemptions only if the liquidity or reserve requirements are not met and then only until such time as they are met. Hence, they do not, under the principles established in ED 37 IAS 32, result in the classification of the financial instrument as equity instruments. Paragraph AG47 of ED 37 IAS 32 states:

Preference shares may be issued with various rights. In determining whether a preference share is a financial liability or an equity instrument, an issuer assesses the particular rights attaching to the share to determine whether it exhibits the fundamental characteristic of a financial liability. For example, a preference share that provides for redemption on a specific date or at the option of the holder contains a financial liability because 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 preference share when contractually required to do so, whether because of a lack of funds, a statutory restriction or insufficient surpluses–~~profits~~ or reserves, does not negate the obligation.* [Emphasis added]

Prohibitions against redemption (paragraphs 7 and 8)

Example 3

Facts

- 16 ~~A6~~–A co-operative entity has issued shares to its members at different dates and for different amounts in the past as follows:

- (a) ~~4~~–January 20X1, 1 100,000 shares at CU10 each (CU1,000,000);
- (b) ~~4~~–January, 1 20X2 100,000 shares at CU20 each (a further CU2,000,000, so that the total for shares issued is CU3,000,000).

Shares are redeemable on demand at the amount for which they were issued.

- 17 ~~A7~~–The entity’s charter states that cumulative redemptions cannot exceed 20 per cent of the highest number of its members’ shares ever outstanding. At ~~31~~–December, 31 20X2 the entity has 200,000 of outstanding shares, which is the highest number of members’ shares ever outstanding and no shares have been redeemed in the past. On ~~4~~–January, 1 20X3 the entity amends its governing charter and increases the permitted level of cumulative redemptions to 25 per cent of the highest number of its members’ shares ever outstanding.

Classification

Before the governing charter is amended

- 18 ~~A8~~–Members’ shares in excess of the prohibition against redemption are financial liabilities. The co-operative entity measures this financial liability at fair value at initial recognition. Because these shares are redeemable on demand, the co-operative entity determines the fair value of such financial liabilities as required by paragraph 49 of ED 37 IAS 39, which states: ‘The fair value of a financial liability with a demand feature (e.g. a demand deposit) is not less than the amount payable on demand ...’ Accordingly, the co-operative entity classifies as financial liabilities the maximum amount payable on demand under the redemption provisions.
- 19 ~~A9~~–On ~~4~~–January, 1 20X1 the maximum amount payable under the redemption provisions is 20,000 shares at CU10 each and accordingly the entity classifies CU200,000 as financial liability and CU800,000 as equity instruments. However, on ~~4~~–January, 1 20X2 because of the new issue of shares at CU20, the maximum amount payable under the redemption provisions increases to 40,000 shares at CU20 each. The issue of additional shares at CU20 creates a new liability that is measured on initial recognition at fair value. The liability after these shares have been issued is 20 per cent of the total shares in issue (200,000), measured at CU20, or CU800,000. This requires recognition of an additional liability of CU600,000. In this example no gain or loss is recognized. Accordingly the entity now classifies CU800,000 as financial liabilities and CU2,200,000 as equity instruments. This example assumes these amounts are not changed between ~~4~~–January, 1 20X1 and ~~31~~–December, 31 20X2.

After the governing charter is amended

- 20 ~~A10~~ Following the change in its governing charter the co-operative entity can now be required to redeem a maximum of 25 per cent of its outstanding shares or a maximum of 50,000 shares at CU20 each. Accordingly, on ~~1~~ January, ~~1~~ 20X3 the co-operative entity classifies as financial liabilities an amount of CU1,000,000 being the maximum amount payable on demand under the redemption provisions, as determined in accordance with paragraph 49 of ~~ED 38 IAS 39~~. It therefore transfers on ~~1~~ January, ~~1~~ 20X3 from net assets/equity to financial liabilities an amount of CU200,000, leaving CU2,000,000 classified as equity instruments. In this example the entity does not recognize a gain or loss on the transfer.

Example 4

Facts

- 21 ~~A11~~ Local law governing the operations of co-operatives, or the terms of the entity's governing charter, prohibit an entity from redeeming members' shares if, by redeeming them, it would reduce paid-in capital from members' shares below 75 per cent of the highest amount of paid-in capital from members' shares. The highest amount for a particular co-operative is CU1,000,000. At the end of the reporting period the balance of paid-in capital is CU900,000.

Classification

- 22 ~~A12~~ In this case, CU750,000 would be classified as equity instruments and CU150,000 would be classified as financial liabilities. In addition to the paragraphs already cited, paragraph 22(b) of ~~ED 37 IAS 32~~ states in part:

... 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, except for those instruments classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18. The financial instrument is a financial liability 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. 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, except for those instruments classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18.

- 23 ~~A13~~ The redemption prohibition described in this example is different from the restrictions described in paragraphs 23 and AG47 of ~~ED 37 IAS 32~~. Those restrictions are limitations on the ability of the entity to pay the amount due on a financial liability, i.e. they prevent payment of the liability only if specified conditions are met. In contrast, this example describes an unconditional prohibition on redemptions beyond a specified amount, regardless of the entity's ability to redeem members' shares (e.g. given its cash resources, surpluses ~~profits~~ or distributable reserves). In effect, the prohibition against redemption prevents the entity from incurring any financial liability to redeem more than a specified amount of paid-in capital. Therefore, the portion of shares subject to the redemption prohibition is not a financial liability. While each member's shares may be redeemable individually, a portion of the total shares outstanding is not redeemable in any circumstances other than liquidation of the entity.

Example 5

Facts

- 24 ~~A14~~ The facts of this example are as stated in example 4. In addition, at the end of the reporting period, liquidity requirements imposed in the local jurisdiction prevent the entity from redeeming any members' shares unless its holdings of cash and short-term investments are greater than a specified amount. The effect of these liquidity requirements at the end of the reporting period is that the entity cannot pay more than CU50,000 to redeem the members' shares.

Classification

- 25 ~~A15~~ As in example 4, the entity classifies CU750,000 as equity instruments and CU150,000 as a financial liability. This is because the amount classified as a liability is based on the entity's unconditional right to refuse redemption and not on conditional restrictions that prevent redemption only if liquidity or other conditions are not met and then only until such time as they are met. The provisions of paragraphs 23 and AG47 of ~~ED 37 IAS 32~~ apply in this case.

Example 6

Facts

- 26 ~~A16~~ The entity's governing charter prohibits it from redeeming members' shares, except to the extent of proceeds received from the issue of additional members' shares to new or existing members during the preceding three years. Proceeds from issuing members' shares must be applied to redeem shares for which members have requested

redemption. During the three preceding years, the proceeds from issuing members' shares have been CU12,000 and no member's shares have been redeemed.

Classification

- 27 ~~A17~~ The entity classifies CU12,000 of the members' shares as financial liabilities. Consistently with the conclusions described in example 4, members' shares subject to an unconditional prohibition against redemption are not financial liabilities. Such an unconditional prohibition applies to an amount equal to the proceeds of shares issued before the preceding three years, and accordingly, this amount is classified as equity instruments. However, an amount equal to the proceeds from any shares issued in the preceding three years is not subject to an unconditional prohibition on redemption. Accordingly, proceeds from the issue of members' shares in the preceding three years give rise to financial liabilities until they are no longer available for redemption of members' shares. As a result the entity has a financial liability equal to the proceeds of shares issued during the three preceding years, net of any redemptions during that period.

Example 7

Facts

- 28 ~~A18~~ The entity is a co-operative bank. Local law governing the operations of co-operative banks state that at least 50 per cent of the entity's total 'outstanding liabilities' (a term defined in the regulations to include members' share accounts) has to be in the form of members' paid-in capital. The effect of the regulation is that if all of a co-operative's outstanding liabilities are in the form of members' shares, it is able to redeem them all. On ~~31~~ December, 31 20X1 the entity has total outstanding liabilities of CU200,000, of which CU125,000 represent members' share accounts. The terms of the members' share accounts permit the holder to redeem them on demand and there are no limitations on redemption in the entity's charter.

Classification

- 29 ~~A19~~ In this example members' shares are classified as financial liabilities. The redemption prohibition is similar to the restrictions described in paragraphs 23 and AG47 of ED 37 IAS 32. The restriction is a conditional limitation on the ability of the entity to pay the amount due on a financial liability, i.e. they prevent payment of the liability only if specified conditions are met. More specifically, the entity could be required to redeem the entire amount of members' shares (CU125,000) if it repaid all of its other liabilities (CU75,000). Consequently, the prohibition against redemption does not prevent the entity from incurring a financial liability to redeem more than a specified number of members' shares or amount of paid-in capital. It allows the entity only to defer redemption until a condition is met, i.e. the repayment of other liabilities. Members' shares in this example are not subject to an unconditional prohibition against redemption and are therefore classified as financial liabilities.

Amendments to other IPSASs

The amendments in this appendix shall be applied for annual financial statements covering periods beginning on or after Month, Day, Year. If an entity applies this Standard for an earlier period, these amendments shall be applied for that earlier period.

- A1 In IPSAS 23, “Revenue from Non-Exchange Transactions (Taxes and Transfers)”, paragraph 37 is amended as follows:

Contributions from Owners

37. Contributions from owners are defined in IPSAS 1. For a transaction to qualify as a contribution from owners, it will be necessary to satisfy the characteristics identified in that definition. In determining whether a transaction satisfies the definition of a contribution from owners, the substance rather than the form of the transaction is considered. Paragraph 38 indicates the form that contributions from owners may take. If, despite the form of the transaction, the substance is clearly that of a loan or another kind of liability, or revenue, the entity recognizes it as such and makes an appropriate disclosure in the notes to the general purpose financial statements, if material. For example, if a transaction purports to be a contribution from owners, but specifies that the reporting entity will pay fixed distributions to the transferor, with a return of the transferor’s investment at a specified future time, the transaction is more characteristic of a loan. For contractual arrangements, an entity also considers the guidance in ED 37, “Financial Instruments: Presentation” when distinguishing liabilities from contributions from owners.

- A2 In IPSAS 1, “Presentation of Financial Statements” (as revised in 2006), the following paragraphs are inserted:

Definitions

- 7A The following terms are described in ED 37, “Financial Instruments: Presentation” and are used in this Standard with the meaning specified in ED 37:
- (a) Puttable financial instrument classified as an equity instrument (described in paragraphs 15 and 16 of ED 37);
 - (b) An instrument that imposes on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and is classified as an equity instrument (described in paragraphs 17 and 18 of ED 37).

Information to be Presented either on the Face of the Statement of Financial Position or in the Notes

95A If an entity has reclassified

- (a) A puttable financial instrument classified as an equity instrument, or
 - (b) An instrument that imposes on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and is classified as an equity instrument
- between financial liabilities and net assets/equity, it shall disclose the amount reclassified into and out of each category (financial liabilities or net assets/equity), and the timing and reason for that reclassification.

Puttable financial instruments classified as net assets/equity [to be included under the section dealing with “capital” which is added as a result of ED 39]

XX For puttable financial instruments classified as equity instruments, an entity shall disclose (to the extent not disclosed elsewhere):

- (a) summary quantitative data about the amount classified as net assets/equity;
- (b) its objectives, policies and processes for managing its obligation to repurchase or redeem the instruments when required to do so by the instrument holders, including any changes from the previous period;
- (c) the expected cash outflow on redemption or repurchase of that class of financial instruments; and
- (d) information about how the expected cash outflow on redemption or repurchase was determined.

A3 In IPSAS 1, paragraph 150 is amended as follows:

Other Disclosures

150 An entity shall disclose the following, if not disclosed elsewhere in information published with the financial statements:

...

- (e) the name of the controlling entity and the controlling entity of the economic entity; and**
- (f) if it is a limited life entity, information regarding the length of its life.**

Illustrative Examples

These examples accompany, but are not part of, ED 37.

Accounting for contracts on equity instruments of an entity

IE1 The following examples illustrate the application of paragraphs 13-32 ~~45-27~~ and IAS 39 to the accounting for contracts on an entity's own equity instruments. In these examples, monetary amounts are denominated in 'currency units' (CU).

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 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:

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

(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 ~~1~~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 ~~31~~January, 31 20X3 in exchange for a payment of CU104,000 in cash (i.e. CU104 per share) on ~~31~~January, 31 20X3. The contract will be settled net in cash. Entity A records the following journal entries.

~~1~~February, 1 20X2

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

~~31~~December, 31 20X2

On ~~31~~December, 31 20X2, 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.

Dr Forward asset	CU6,300	
		CU6,300
Cr Gain		

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

31 January, 31 20X3

On ~~31~~ January, 31 20X3, the market price per share has decreased to CU106. The fair value of the forward contract is CU2,000 [(CU106 × 1,000) – CU104,000].

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 (CU106 × 1,000) to Entity A, so Entity B pays the net amount of CU2,000 to Entity A.

Dr Loss	CU4,300	
		CU4,300
Cr Forward asset		

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

Dr Cash	CU2,000	
		CU2,000
Cr Forward asset		

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:

31 January, 31 20X3

The contract is settled net in shares. Entity A has an obligation to deliver CU104,000 (CU104 × 1,000) worth of its shares to Entity B and Entity B has an obligation to deliver CU106,000 (CU106 × 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 <u>Net assets/equity</u>	CU2,000	
		CU2,000
Cr Forward asset		

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 × 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.

1 February, 1 20X2

Dr <u>Net assets/equity</u>	CU100,000	
		CU100,000
Cr Liability		

To record the obligation to deliver CU104,000 in one year at its present value of CU100,000 discounted using an appropriate interest rate (see IAS 39, paragraph AG64).

~~31~~December, 31 20X2

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.

~~31~~January, 31 20X3

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 recognises 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 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:

Contract date	4 February, <u>1</u> 20X2
Maturity date	31 January, <u>31</u> 20X3

Market price per share on 4 February, <u>1</u> 20X2	CU100
Market price per share on 31 December, <u>31</u> 20X2	CU110
Market price per share on 31 January, <u>31</u> 20X3	CU106
Fixed forward price to be paid on 31 January, <u>31</u> 20X3	CU104
Present value of forward price on 4 February, <u>1</u> 20X2	CU100
Number of shares under forward contract	1,000
Fair value of forward on 4 February, <u>1</u> 20X2	CU0
Fair value of forward on 31 December, <u>31</u> 20X2	(CU6,300)

Fair value of forward on ~~31~~January, 31 20X3 (CU2,000)

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

IE8 On ~~1~~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 ~~31~~January, 31 20X3 in exchange for CU104,000 in cash (i.e. CU104 per share) on ~~31~~January, 31 20X3. The contract will be settled net in cash. Entity A records the following journal entries.

1 February, 1 20X2

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

31-December, 31 20X2

Dr Loss	CU6,300	
	Cr Forward liability	CU6,300

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

31-January, 31 20X3

Dr Forward liability	CU4,300	
	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:

31-January, 31 20X3

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 Forward liability	CU2,000	
	Cr <u>Net assets/equity</u>	CU2,000

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

~~1~~February, 1 20X2

No entry is made on ~~1~~ February, 1. 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.

~~31~~December, 31 20X2

No entry is made on ~~31~~ December, 31 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.

~~31~~January, 31 20X3

On ~~31~~ January, 31 20X3, Entity A receives CU104,000 in cash and delivers 1,000 shares.

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

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 recognises 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:

Contract date	1 February, <u>1</u> 20X2
Exercise date	31 January, <u>31</u> 20X3
	(European terms, i.e. it can be exercised only at maturity)
Exercise right holder	Reporting entity (Entity A)
Market price per share on 1 February, <u>1</u> 20X2	CU100
Market price per share on 31 December, <u>31</u> 20X2	CU104
Market price per share on 31 January, <u>31</u> 20X3	CU104
Fixed exercise price to be paid on 31 January, <u>31</u> 20X3	CU102
Number of shares under option contract	1,000
Fair value of option on 1 February, <u>1</u> 20X2	CU5,000
Fair value of option on 31 December, <u>31</u> 20X2	CU3,000
Fair value of option on 31 January, <u>31</u> 20X3	CU2,000

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

IE13 On ~~4~~ 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 ~~31~~ January, 31 20X3 in exchange for CU102,000 in cash (i.e. CU102 per share) on ~~31~~ January, 31 20X3, 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.

~~1~~ February, 1 20X2

The price per share when the contract is agreed on ~~4~~ February, 1 20X2 is CU100. The initial fair value of the option contract on ~~4~~ 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.

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

To recognise the purchased call option.

~~31~~ December, 31 20X2

On ~~31~~ December, 31 20X2, 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.

~~31~~ January, 31 20X3

On ~~31~~ January, 31 20X3, 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:

~~31~~ January, 31 20X3

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 <u>Net assets/equity</u>	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.

1 February, 1 20X2

Dr <u>Net assets/equity</u>	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 recognised in net assets/equity.

31 December, 31 20X2

No entry is made on ~~31~~ December, 31 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.

31 January, 31 20X3

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 <u>Net assets/equity</u>	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 recognises 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	1 February, <u>1</u> 20X2
Exercise date	31 January, <u>31</u> 20X3

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

Exercise right holder	Counterparty (Entity B)
Market price per share on 1 February, <u>1</u> 20X2	CU100
Market price per share on 31 December, <u>31</u> 20X2	CU104
Market price per share on 31 January, <u>31</u> 20X3	CU104
Fixed exercise price to be paid on 31 January, <u>31</u> 20X3	CU102
Number of shares under option contract	1,000
Fair value of option on 1 February, <u>1</u> 20X2	CU5,000
Fair value of option on 31 December, <u>31</u> 20X2	CU3,000
Fair value of option on 31 January, <u>31</u> 20X3	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 ~~1~~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 ~~31~~January, 31 20X3 in exchange for CU102,000 in cash (i.e. CU102 per share) on ~~31~~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.

~~1~~ February, 1 20X2

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

To recognise the written call option.

~~31~~December, 31 20X2

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

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

~~31~~ January, 31 20X3

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:

31-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 ($\text{CU104} \times 1,000$) worth of Entity A's shares to Entity B in exchange for CU102,000 ($\text{CU102} \times 1,000$) 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 ($\text{CU2,000}/\text{CU104}$).

Dr Call option obligation	CU2,000	
Cr <u>Net assets/equity</u>		CU2,000

To record the settlement of the option contract. The settlement is accounted for as a transaction in net assets/equity ~~an equity 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 ($\text{CU102} \times 1,000$) in cash, if Entity B exercises its option. Entity A records the following journal entries.

1-February, 1 20X2

Dr Cash	CU5,000	
Cr <u>Net assets/equity</u>		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 recognised in net assets/equity. Upon exercise, the call would result in the issue of a fixed number of shares in exchange for a fixed amount of cash.

31-December, 31 20X2

No entry is made on 31 December 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.

31-January, 31 20X3

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 <u>Net assets/equity</u>		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 recognises 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	4 February, <u>1</u> 20X2
Exercise date	31 January, <u>31</u> 20X3 (European terms, i.e. it can be exercised only at maturity)
Exercise right holder	Reporting entity (Entity A)
Market price per share on 4 February, <u>1</u> 20X2	CU100
Market price per share on 31 December, <u>31</u> 20X2	CU95
Market price per share on 31 January, <u>31</u> 20X3	CU95
Fixed exercise price to be paid on 31 January, <u>31</u> 20X3	CU98
Number of shares under option contract	1,000
Fair value of option on 4 February, <u>1</u> 20X2	CU5,000
Fair value of option on 31 December, <u>31</u> 20X2	CU4,000
Fair value of option on 31 January, <u>31</u> 20X3	CU3,000

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

IE23 On 4 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 ~~31~~ January, 31 20X3 at a strike price of CU98,000 (i.e. CU98 per share) on ~~31~~ January, 31 20X3, 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.

4 February, 1 20X2

The price per share when the contract is agreed on 4 February, 1 20X2 is CU100. The initial fair value of the option contract on 4 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 recognise the purchased put option.

31 December, 31 20X2

On ~~31~~ December 20X2 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 $[(CU98 - CU95) \times 1,000]$ 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.

31 January, 31 20X3

On ~~31~~ January, 31 20X3 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 $[(CU98 - CU95) \times 1,000]$ 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 $(CU95 \times 1,000)$ 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:

31 January, 31 20X3

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 $(CU3,000/CU95)$.

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

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.

1 February, 1 20X2

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

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 recognised directly in net assets/equity. Upon exercise, it results in the issue of a fixed number of shares in exchange for a fixed price.

~~31~~ December, 31 20X2

No entry is made on ~~31~~ December, 31 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.

~~31~~ January, 31 20X3

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.

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

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 recognises 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, <u>1</u> 20X2
Exercise date	31 January, <u>31</u> 20X3
	(European terms, i.e. it can be exercised only at maturity)
Exercise right holder	Counterparty (Entity B)
Market price per share on + February, <u>1</u> 20X2	CU100
Market price per share on 31 December, <u>31</u> 20X2	CU95
Market price per share on 31 January, <u>31</u> 20X3	CU95
Fixed exercise price to be paid on 31 January, <u>31</u> 20X3	CU98
Present value of exercise price on + February, <u>1</u> 20X2	CU95
Number of shares under option contract	1,000
Fair value of option on + February, <u>1</u> 20X2	CU5,000
Fair value of option on 31 December, <u>31</u> 20X2	CU4,000
Fair value of option on 31 January, <u>31</u> 20X3	CU3,000

(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 4 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 ~~31~~ January, 31 20X3 in exchange for CU98,000 in cash (i.e. CU98 per share) on ~~31~~ 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.

~~4~~February, 1 20X2

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

To recognise the written put option.

~~31~~December, 31 20X2

Dr Put option liability	CU1,000	
Cr Gain		CU1,000

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

~~31~~January, 31 20X3

Dr Put option liability	CU1,000	
Cr Gain		CU1,000

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 (CU95 × 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:

~~31~~January, 31 20X3

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 (CU95 × 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 <u>Net assets/equity</u>		CU3,000

To record the settlement of the option contract. The issue of Entity A's own shares is accounted for as a transaction in net assets/equity ~~an equity 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 (CU98 × 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.

1 February, 1 20X2

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

To recognise the option premium received of CU5,000 in net assets/equity.

Dr <u>Net assets/equity</u>	CU95,000	
	Cr Liability	CU95,000

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

31 December, 31 20X2

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.

31 January, 31 20X3

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 × 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 recognises 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 IAS 32

Example 7: Entities with no net assets/equity

IE32 The following example illustrates a format of a statement of financial performance comprehensive income and statement of financial position that may be used by entities such as mutual funds that do not have net assets/equity as defined in IAS 32. Other formats are possible.

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

	20X1	20X0
	CU	CU
Revenue	2,956	1,718
Total Revenue	2,956	1,718
Expenses (classified by nature or function)	(644)	(614)
Finance costs		
– other finance costs	(47)	(47)
– distributions to unitholders	(50)	(50)
Total Expenses	(741)	(711)
Profit from operating activities	2,312	1,104
Finance costs		
– other finance costs	(47)	(47)
– distributions to unitholders	(50)	(50)
Surplus for the year	2,215	1,007
Change in net assets attributable to unitholders	2,215	1,007

Statement of financial position at 31-December, 31 20X1

	20X1	20X0
	CU	CU
ASSETS		
Non-current assets (classified in accordance with IPSAS 1 IAS 4)	91,374	78,484
Total non-current assets	91,374	78,484
Current assets (classified in accordance with IPSAS 1 IAS 4)	1,422	1,769
Total current assets	1,422	1,769
Total assets	92,796	80,253
LIABILITIES		
Current liabilities (classified in accordance with IPSAS 1 IAS 4)	647	66
Total current liabilities	(647)	(66)
Non-current liabilities excluding net assets attributable to	280	136

unitholders (classified in
accordance with IPSAS 1)

	(280)	(136)
Net assets attributable to unitholders	91,869	80,051

Example 8: Entities with some net assets/equity

IE33 The following example illustrates a format of a statement of financial performance ~~comprehensive income~~ and statement of financial position that may be used by entities whose share capital is not net assets/equity as defined in IAS 32 because the entity has an obligation to repay the share capital on demand. Other formats are possible.

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

	20X1	20X0
	CU	CU
Revenue	472	498
<u>Total Revenue</u>	<u>472</u>	<u>498</u>
Expenses (classified by nature or function)	(367)	(396)
<u>Finance costs</u>		
– other finance costs	(4)	(4)
– distributions to members	(50)	(50)
<u>Total Expenses</u>	<u>(421)</u>	<u>(450)</u>
Profit from operating activities	105	102
Finance costs		
– other finance costs	(4)	(4)
– distributions to members	(50)	(50)
<u>Surplus for the year</u>	<u>51</u>	<u>48</u>
Change in net assets attributable to members	51	48

Statement of financial position at ~~31~~ December, 31 20X1

	20X1	20X0
	CU	CU
ASSETS		
Non-current assets (classified in accordance with <u>IPSAS 1</u>)	908	830
Total non-current assets	908	830
Current assets (classified in accordance with <u>IPSAS 1</u>)	383	350

Total current assets	383	350
Total assets	<u>1,291</u>	<u>1,180</u>
LIABILITIES		
Current liabilities (classified in accordance with IPSAS 1 IAS 4)	372	338
Share capital repayable on demand	<u>202</u>	<u>161</u>
Total current liabilities	(574)	(499)
Total assets less current liabilities	<u>717</u>	<u>681</u>
Non-current liabilities (classified in accordance with IPSAS 1 IAS 4)	187	196
	(187)	(196)
OTHER COMPONENTS OF EQUITY^(a)		
Reserves e.g. revaluation surplus, <u>accumulated surplus</u> retained earnings etc	<u>530</u>	<u>485</u>
	530	485
	<u>717</u>	<u>681</u>
MEMORANDUM NOTE – Total members’ interests		
Share capital repayable on demand	<u>202</u>	<u>161</u>
Reserves	<u>530</u>	<u>485</u>
	<u>732</u>	<u>646</u>

(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 33 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 component of net assets/equity component ~~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.

	CU
Present value of the principal – CU2,000,000 payable at the end of three years	1,544,367
Present value of the interest – CU120,000 payable annually in arrears for three years	303,755
Total liability component	1,848,122
<u>Component of net assets/equity component</u> (by deduction)	151,878
Proceeds of the bond issue	<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 36 to the separation of ~~the liability and equity components of a compound financial instrument with multiple embedded derivative features~~ into the liability component and the component of net assets/equity.

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 equity 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 an equity conversion option is CU2. In this case, the value allocated to the liability component under paragraph 36 is CU55 (CU57 – CU2) and the value allocated to the component of net assets/equity component is CU5 (CU60 – CU55).

Example 9: 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 the liability component and the component of net assets/equity 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 4 January, 1 20X0, Entity A issued a 10 per cent convertible debenture with a face value of CU1,000 maturing on 31 December, 31 20X9. 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:

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

IE42 On 4 January, 1 20X5, 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:

	Carrying value	Fair value	Difference
Liability component:	CU	CU	CU
Present value of 10 remaining half-yearly interest payments of CU50, discounted at 11% and 8%, respectively	377	405	
Present value of CU1,000 due in 5 years, discounted at 11% and 8%, compounded half-yearly, respectively	585	676	
	<u>962</u>	<u>1,081</u>	<u>(119)</u>
<u>Component of net assets/equity component</u>	60	619 ^(a)	(559)
Total	<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 recognises the repurchase of the debenture as follows:

Dr Liability component	CU962	
Dr Debt settlement expense (profit or loss <u>surplus or deficit</u>)	CU119	
Cr Cash		CU1,081

To recognise the repurchase of the liability component.

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

To recognise the cash paid for the component of net assets/equity component.

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

Example 11: 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 4 January, 1 20X0, Entity A issued a 10 per cent convertible debenture with a face value of CU1,000 with the same terms as described in Example 9. On 4 January, 1 20X1, to induce the holder to convert the convertible debenture promptly, Entity A reduces the conversion price to CU20 if the debenture is converted before 4 March, 1 20X1 (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:*

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

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

Face amount	CU1,000
Original conversion price	<u>/CU25</u> per share
Number of ordinary shares to be issued on conversion	40 Shares
<i>Number of incremental ordinary shares issued upon conversion</i>	10 Shares

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

CU40 per share x 10 incremental shares	<u>CU400</u>
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IE48 The incremental consideration of CU400 is recognised as a loss in surplus or deficit ~~profit or loss~~.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, ED 37.

Introduction

- BC1. This Basis for Conclusions summarizes the International Public Sector Accounting Standards Board's (IPSASB) considerations in reaching the conclusions in ED 37, "Financial Instruments: Presentation". As this IPSAS is based on IAS 32, "Financial Instruments: Presentation" issued by the International Accounting Standards Board (IASB), the Basis for Conclusions outlines only those areas where the ED 37 deviates from the main requirements of IAS 32.
- BC2. This project on financial instruments is noted as a key part of the IPSASB's convergence program which aims to converge IPSASs with International Financial Reporting Standards (IFRSs). The IPSASB acknowledges that there are other aspects of financial instruments, insofar as they relate to the public sector, which are not addressed in IAS 32. These may be addressed by future projects of the IPSASB. In particular, the IPSASB acknowledges that future projects may be required to address:
- Certain transactions undertaken by central banks; and
 - Receivables and payables that arise from arrangements that are, in substance, similar to, and have the same economic effect as, financial instruments, but are not contractual in nature.
- BC3. In developing this IPSAS, the IPSASB agreed to retain the existing text of IAS 32 making changes to ensure consistency with the terminology and presentational requirements of other IPSASs, and deal with any public sector specific issues through additional application guidance.
- BC4. In September 2007 the IASB issued amendments to IAS 1, "Presentation of Financial Statements" which introduced a new component into the presentation of financial statements called "comprehensive income". As the IPSASB has not yet considered this, along with some of the other amendments proposed in IAS 1, those amendments have not been included in ED 37.

Scope

Insurance and Financial Guarantee Contracts

- BC5. IAS 32 excludes all insurance contracts from the scope of IAS 32, except for financial guarantee contracts where the issuer elects to apply International Financial Reporting Standard 4 "Insurance Contracts" (IFRS 4) in recognizing and measuring such contracts. The scope of ED 37 also excludes all insurance contracts, except that:
- All financial guarantee contracts are to be treated as financial instruments in terms of ED 37, ED 38 and ED 39; and
 - Contracts that are insurance contracts but involve the transfer financial risk may be treated as financial instruments in terms of ED 37, ED 38 and ED 39.

Defining Insurance Contracts

- BC6. IPSAS 15, issued in 2001, included a description of insurance contracts. Given that the IASB issued IFRS 4 after IPSAS 15, the existing description of an insurance contract has been replaced with the definition of an insurance contract from IFRS 4. The definition of an insurance contract has been included as part of the application guidance rather than as an additional definition in the main text of ED 37. The reason for this is that the Board has not yet considered insurance contracts in the public sector; therefore to include this as a defined term in the IPSASs would be premature.

Treating Financial Guarantees as Financial Instruments

- BC6. Under IAS 32, financial guarantee contracts should be treated as financial instruments, unless an issuer elects to apply IFRS 4 to those contracts. The IPSASB considered whether it should allow this option in ED 37. If the IPSASB allowed this alternative treatment, ED 37 would refer entities to either the international or national accounting standard dealing with insurance contracts there is no equivalent IPSAS to IFRS 4.
- BC7. Depending on local circumstances, this would mean that some entities would apply IFRS 4 while others would apply their own national practices in accounting for financial guarantee contracts. The application of different accounting principles for recognizing and measuring similar instruments would reduce the comparability of financial statements from one entity to another and one jurisdiction to another. So as to achieve comparability of financial statements and, given the significance of financial guarantees in the public sector, the IPSASB believes it

is appropriate to deal definitively with the accounting for financial guarantees by proposing a single accounting treatment.

Option to Treat Insurance Contracts that Transfer Financial Risk as Financial Instruments

- BC8. IPSAS 15 allowed entities to account for instruments that are insurance contracts that result in the transfer of financial risk, as financial instruments. In the absence of an IPSAS on insurance contracts, the IPSASB concluded that it should allow entities to apply ED 37 to such contracts.

Identifying Contractual Financial Guarantees

- BC9. Financial instruments in ED 37 are defined as: "...any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity". As arrangements in the public sector may arise through statutory powers, the IPSASB developed additional application guidance to explain when financial guarantees are contractual or non-contractual. In considering this issue, the IPSASB concluded that financial guarantees should have the key features of a contractual arrangement. It also concluded that an entity should: distinguish the right to issue guarantees, which is often conferred on an entity through statutory or similar means, and the actual issuing of the guarantee in favour of a third party, irrespective of whether that party is explicitly or implicitly identified.

Definitions

Contractual Arrangements

- BC10. Assets and liabilities in the public sector arise in a variety of ways. Non-contractual arrangements do not give rise to financial instruments because the definition of a financial instrument refers to a 'contract'. The IPSASB noted that, in certain jurisdictions, public sector entities are precluded from entering into formal contracts, but do enter into arrangements that have the substance of ~~contracts~~The contracts. The IPSASB considered it appropriate to issue additional Application Guidance explaining the factors an entity should consider in assessing whether an arrangement is contractual or non-contractual.

Contractual Non-Exchange Revenue Transactions

- BC11. IPSAS 23, "Revenue from Non-Exchange Transactions (Taxes and Transfers)" prescribes the initial recognition, initial measurement and disclosure of assets and liabilities arising out of non-exchange revenue transactions. In acknowledging that certain non-exchange revenue transactions may be contractual in nature, there is an overlap between the requirements of ED 37 and IPSAS 23.
- BC12. The IPSASB concluded that an entity should apply the requirements of IPSAS 23 in conjunction with ED 37. In particular, an entity considers the principles in ED 37 in considering whether an inflow of resources from a non-exchange revenue transaction results in a liability or a transaction that evidences a residual interest in the net assets of the entity.

Other

Interpretations developed by the International Financial Reporting Interpretations Committee

- BC13. The IPSASB considered whether IFRIC 2, "Members' Shares in Co-operative Entities and Similar Instruments" and IFRIC 11, "IFRS2 – Group and Treasury Share Transactions" were relevant for the types of instruments entered into by governments and entities in the public sector.
- BC14. The IPSASB considered that IFRIC 11 is not relevant for the types of instruments entered into in the public sector as it deals with share-based payment transactions. While share-based payments may be common in Government Business Enterprises (GBEs), they do not occur frequently within entities that are not GBEs. As a result, the IPSASB has not included any principles from IFRIC 11 in ED 37.
- BC15. IFRIC 2 provides guidance on the application of IAS 32 to members' shares in co-operative entities and similar instruments. There is a strong link between IAS 32 and IFRIC 2 in relation to puttable financial instruments and obligations arising on liquidation. As the text of IAS 32 that deals with puttable financial instruments and obligations arising on liquidation has been retained in ED 37, IFRIC 2 would provide additional guidance to users of ED 37 in applying those principles to members' interests in co-operative entities. The principles and examples from IFRIC 2 have been added to ED 37 as an authoritative appendix.

Comparison with IAS 32

International Public Sector Accounting Standard ,xx (ED 37) “Financial Instruments: Presentation” is drawn primarily from International Accounting Standard 32, “Financial Instruments: Presentation” (issued originally in 2003, including amendments up to December, 31 2008). At the time of issuing this Standard, the IPSASB has not yet considered the revision made by the IASB to IAS 1, “Presentation of Financial Statements” which introduces the concept of comprehensive income. As the IPSASB has not considered the concept of comprehensive income in the public sector, ED 37 does not reflect amendments made to IAS 32 as a consequence of the revisions made to IAS 1. The main differences between ED 37 and IAS 32 (2003) are as follows:

- The scope of ED 37 is different from IAS 32. This Standard requires financial guarantee contracts to be treated as financial instruments and not as insurance contracts. In IAS 32 entities are permitted to treat some financial guarantee contracts as insurance contracts.
- In certain instances, ED 37 uses different terminology from IAS 32. The most significant examples are the use of the terms “statement of financial performance” and “net assets/equity”. The equivalent terms in IAS 32 are “statement of comprehensive income or separate income statement (if presented)” and “equity”.
- ED 37 does not distinguish between “revenue” and “income”. IAS 32 distinguishes between “revenue and “income”, with “income having a broader meaning than the term “revenue”.
- Additional Application Guidance has been developed to explain the application of the principles in ED 37 to financial instruments held in the public sector and to deal with certain public sector issues not addressed in IAS 32.
- Certain examples included in the text, Application Guidance and Illustrative Examples have either been amended or deleted based on their applicability to the public sector.
- Principles from IFRIC 2, “Members’ Shares in Co-operative Entities and Similar Instruments” have been included as an Appendix to this Standard,
- The transitional provisions in ED 37 differ from those in IAS 32. This is because ED 37 provides transitional guidance for those entities applying this Standard for the first time or those applying accrual accounting for the first time.